CHAPTER 2

LOAN PROCESSING

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PURPOSES/USE OF PROCEEDS

<u>Eligible Uses:</u>

- Purchase inventory, supplies and raw materials
- Purchase furniture, fixtures, machinery and equipment
- Purchase or construct business premises
- Construct buildings or leasehold improvements
- Purchase a business or buy out a stockholder
- Repay existing trade payables
- Provide working capital
- Debt refinancing - see criteria on following page

NOTE: TOTAL LOAN AMOUNT SHOULD BE ROUNDED TO THE NEAREST ONE HUNDRED DOLLARS.

DEBT REFINANCING

A Borrower may not use 7(a) loan proceeds to pay any creditor in a position to sustain a loss causing a shift to SBA of all or part of a potential loss from an existing debt.

It is the policy of the Agency that debt refinancing must provide a substantial benefit to the applicant. Refinancing a debt to provide the lender with an improved lien position or other factors that only benefit the lender does not constitute an acceptable justification for refinancing any existing debt.

To be eligible for refinancing by SBA, existing debt must not be available on reasonable terms AND the refinancing must provide a substantial benefit to the small business:

"Substantial benefit" is defined as significant improvement to cash flow.

a. For short-term loans, to a longer term if business circumstances require

b. For long-term loans, at least 20% improvement to existing debt service.

"20% improvement" is defined as: The new payment must be at least 20% less than the existing payment. To calculate, use the monthly P&I comparison. Improved cash flow must be needed for some viable business purpose, not to increase owner's draw.

- Compare P&I of existing debt to the payment on that amount of funds under the new, proposed loan terms.

- The improvement must reflect that 20% or less dollars are required to service the new amount.

- DO NOT compare the entire new loan to the existing debt being refinanced. Compare only the amount of funds necessary to repay the existing debt. Use the new loan terms to determine the new payment amount as if you were doing nothing more than refinance.

- **Balloon notes** are not considered to be on reasonable terms and are not subject to the 20% test.

- **Interest only debts, credit card debts and trade payables** can be classified as short-term debts and are not subject to the 20% test.

What about **multiple notes**?

- Change in debt service of each debt must be determined. No debt being refinanced is permitted to have a higher debt service requirement after debt refinancing than prior to refinancing. (Exceptions to this policy require approval from SBA headquarters.)

- Combined debt service must improve cash flow by 20%.
- Individual debts do need to show an improvement in cash flow but not necessarily the full 20%.

THE FOLLOWING MUST BE ADDRESSED WHEN REFINANCING IS REQUESTED:

- Why was the debt incurred?
- Has over-obligated or imprudent debt scheduling necessitated a major restructuring of the debt?
- Is the present debt already on reasonable terms?
- How will the new loan improve the financial condition of the firm?
- What benefit will refinancing give the applicant?
- Does the refunding include payments to creditors in a position to sustain a loss due to either an inadequate collateral position or low deficit of net worth?
- Would SBA be likely to sustain part or all of the same loss by refinancing the debt or will additional collateral or altered terms protect the interest of the Agency?
- What portion of the total loan does the refinancing constitute?
- If credit card debt, for what business purpose was the credit card debt incurred?

ON ALL DEBT REFINANCING, the following is required:

- Copies of all original and renewal notes.
- An explanation of what the original proceeds were used for and what collateral was given to secure the debt.
- Maturity tied to the useful life of the collateral.

REFINANCING PARTICIPANT'S OWN DEBT:

In addition to the requirements for all debt refinancing, the lender must:

- Certify in writing that subject debt is and has always been current for at least the last 36 months. Current means that a required payment has not remained unpaid for more than 29 days. A loan that includes a payment unpaid for 30 days, subsequently deferred, was not current on that 30th day and is not eligible for refinancing.

- Provide a transcript of the borrower's account with the application showing that the loan to be refinanced is current and has been current for the least the last 36 months.

SBA reserves the right to reduce the guaranty percentage on debt refinancing if it is determined by SBA that the debt is not adequately secured.

REFINANCING SBA DEBT: In the case of refinancing existing SBA debt, a more strict justification must be met.

- Refinancing is authorized only when the existing holder is unwilling/unable to provide more needed credit.
- SBA will obtain confirmation of circumstances from existing lender.

REFINANCING PARTICIPANT'S OWN EXISTING SBA DEBT:

- Refinancing is only allowed for secondary market loans where investor will not renegotiate terms.
- Lenders and SBA should cooperate in adjusting terms of existing SBA loans when possible to avoid refinancing.

Refinancing of existing SBA loans is not to be done except in the above very narrow circumstances. We believe needed capital for small businesses can be extended with the cooperation of the lenders and the support of the field offices, without constant rollovers of existing SBA loans.

Refinancing of SBA debt is not eligible through PLP.

REFINANCING CREDIT CARD DEBT: SBA will consider credit card debt if the applicant has documentation that the use of the credit card was business related. The documentation to support that the debt was business related **must** be submitted to SBA along with the application. Credit cards are considered "account payables" and are not required to meet the 20% improvement in cash flow rule.

Further, based on the amount of the credit card debt, we may need to consider closing the credit card account and requiring the applicant to execute an affidavit that additional credit card debt for the business will not be incurred without the bank's written permission.

INTERIM LOAN: The practice of a lender notifying SBA of an interim loan has been discontinued. Current legislation does not include a different guaranty rate for refinancing and therefore, prior notice to SBA is not needed. When a lender advances funds, whether with or without SBA's knowledge, it does so at its own risk.

Exercise: Take a few minutes to answer the following questions related to debt refinancing situations. Answers are included in Appendix 2-A.

1. A business has $200M in debt paying @ $17,000/month. It needs $300M more in M&E financing. Terms offered by lender are $500M for 5 years @ $10,600/month. Can SBA guaranty loan provide this credit?

2. In situation above, the original debt is paying @ $5,250/month. Now is it eligible?

3. A different business has $300M of existing debt in two notes. Note one is $200M paying @ $5,250/month. Note two is for $100M paying @ $3,350/month. Business needs $300M more. Can an SBA guaranteed loan finance the entire $600M new loan at desired terms of 5 years paying @ $12,750?

GUARANTY PERCENTAGE AND FEES

GUARANTY PERCENTAGE

The maximum loan size for an SBA guaranteed loan is $2,000,000; however, the guaranty (SBA's portion) is limited to $1,000,000 with the following two exceptions:

- International Trade Loans - maximum guaranty is $1,250,000

- 504 Loans - maximum debenture is $1,300,000 if project involves public policy goals

The maximum allowable guaranty percentage on a loan will be determined by the loan amount: loans of $150,000 or less may receive a maximum guaranty of 85 percent; all other loans, except EWCP (which is 90%), may receive a maximum guaranty of 75 percent, not to exceed $1,000,000.

THE GUARANTY PERCENTAGE SHOULD BE ROUNDED TO THE NEAREST TENTH OF ONE PERCENT.

GUARANTY FEE

SBA charges a one-time guaranty fee to the lender obtaining its guaranty. The guaranty fee is charged only on the **guaranteed portion** of the loan and is computed as follows:

For loans with a maturity of 12 months or less:

- The guaranty fee is 0.25% of the guaranteed portion and must be paid to SBA with the application OR before SBA signs the authorization.

- Lender may recover the fee from the Borrower after SBA approves the loan.

For loans with a maturity greater than 12 months:

Note: Effective 10-1-02 through 9-30-04, the fee structure is as follows:

- If the TOTAL loan amount is $150,000 or less, the guaranty fee is 1% of the guaranteed portion. (NOTE: As an incentive to lenders to make smaller loans, lenders are permitted to retain 25 percent of this fee.)

- If the TOTAL loan amount is more than $150,000 up to and including $700,000, the guaranty fee is 2.5% of the guaranteed portion.

- If the TOTAL loan amount is more than $700,000, the guaranty fee is 3.5% of the guaranteed portion.

Note: Loans (with maturities greater than 12 months) to the same borrowing entity within any 90-day period will be treated as a single loan for purposes of calculating the guaranty fee.

The fee for loans with maturity of more than 12 months is payable to the SBA within 90 days of SBA approval (date of Authorization). Lender may pass the fee to the Borrower only after the Lender has paid the fee to SBA and the first disbursement has occurred on the loan. The Borrower may use working capital loan proceeds (if working capital has been authorized) to reimburse the Lender for the guaranty fee. If the required guaranty fee has not been paid within 120 days from the date of the Authorization, SBA will automatically terminate the guarantee.

WE WILL NO LONGER EXTEND PAYMENT OF THE GUARANTY FEE WHEN WE EXTEND THE INITIAL DISBURSEMENT PERIOD. THE REQUIRED GUARANTY FEE MUST BE SUBMITTED AND PAID AS STATED ABOVE.

When an increase in the loan amount is required, the appropriate increase in the guaranty fee must accompany the request. Otherwise, the request for the increase will not be accepted or processed.

Acceptance of the guaranty fee by SBA shall not waive any right of SBA arising from the Lender's misconduct or violation of any provision of this part, the guarantee agreement, the Authorization, or other loan documents.

REBATE OF GUARANTY FEE (Form 750):

- For loans with a maturity of 12 months or less, the lender must request cancellation of the loan and return of the fee within 30 calendar days from the date of SBA approval. The fee will be refunded if the application is withdrawn, denied, or if SBA substantially changes the Lender's terms and the modified terms are unacceptable to the Borrower or Lender.

- For loans with a maturity greater than 12 months, the lender must request cancellation of the loan and return of the fee while the loan remains fully undisbursed.

SERVICING FEE

The on-going servicing fee of 0.50 percent (50 basis points) on the outstanding balance of the SBA guaranteed portion of the loan will be reduced to 0.25 percent (25 basis points) for all loans approved on or after 10-1-02 through 9-30-04. The fee is paid monthly only if any interest has been collected from the Borrower during the month. The service fee cannot be charged to the Borrower. (See Servicing Section of this training manual for instructions on how to calculate and remit this fee).

OTHER FEES

Application Fees: Processing fees, origination fees, application fees, points, brokerage fees, bonus points, referral or similar fees which might be charged an applicant **are not permitted**.

Packaging Fees: The Lender may charge an applicant reasonable fees (customary for similar lenders in the geographic area where the loan is being made) for packaging and other services. The Lender must advise the applicant in writing that the applicant is not required to obtain or pay for unwanted services. The applicant is responsible for deciding whether fees are reasonable. SBA may review these fees at any time. The Lender must refund any such fee considered unreasonable by SBA.

Closing Fees: The Lender may collect from the applicant necessary out-of-pocket expenses such as: surveys, title reports, appraisals, filing and recording fees, photocopy and delivery charges, and other direct charges related to the closing. The Lender or its Associate may not charge the Borrower for legal services, unless they are hourly charges for requested services actually rendered.

Extraordinary Servicing: Subject to prior written SBA approval, if all or part of a loan will have extraordinary servicing needs, the Lender may charge the applicant a service fee not to exceed 2 percent per year on the outstanding balance of the part requiring special servicing.

Extraordinary servicing fees can be charged in those situations where the lender will have to expend added time to properly monitor the account. These situations would include:

- construction loans requiring field inspections, monitoring of draw schedules, title reports, etc.

- loans secured by accounts receivable and/or inventory that require monitoring and inspections of that collateral

Premiums: The Lender or its Associate may not share any premium received from the sale of an SBA guaranteed loan in the secondary market with any other entity or individual not directly compensated by the lender.

Late Payment Fee: For loans approved on or after 9/1/93, the Lender may charge the Borrower a late payment fee not to exceed 5 percent of the regular loan payment if a payment is more than 10 days late.

Prepayment Fee: For loans where the applications were received by the lender on or after December 22, 2000:

- A prepayment charge paid by the borrower to SBA ("subsidy recoupment fee") has been added for those loans that meet the following criteria:

    1. Have a maturity of 15 years or more where the borrower is prepaying voluntarily;

    2. The prepayment amount exceeds 25 percent of the outstanding balance of the loan; AND

3. The prepayment is made within the first 3 years after the date of the first disbursement (**not approval date**) of the loan proceeds.

- The prepayment fee calculation is as follows:

  During the **first year** after initial disbursement, 5 percent of the prepayment amount;

  During the **second year** after initial disbursement, 3 percent of the prepayment amount;

  During the **third year** after initial disbursement, 1 percent of the prepayment amount.

Note: "Outstanding loan balance" for the first 12 months from date of initial disbursement will be based upon the approved loan amount; for the second 12 months from date of initial disbursement, it will be based upon the loan amount that is owed on the 1-year anniversary from the date of initial disbursement; for the third 12 months from date of initial disbursement, it will be based upon the amount that is owed on the 2-year anniversary from the date of initial disbursement.

The above prepayment fee is in addition to any interest charge that may be required from the secondary market when they are not given proper advance written notice prior to prepayment.

MATURITY

Most SBA loans are used to finance the long-term needs of small business. Maturities are expected to be commensurate with the business's ability to repay and the remaining useful life of the assets being financed.

The specific maturity of a loan is determined by:

- use of the proceeds
- useful life of the assets being financed
- ability to repay

Loans for **working capital** purposes will not exceed 7 years, except in cases where a longer maturity (up to 10 years) may be needed to assure repayment. The maximum maturity of loans used to finance **fixed assets other than real estate** will be limited to the **economic life of those assets** but not to exceed 25 years (generally equipment loans are limited to 10 years or less). The 25-year maximum maturity will generally apply to the **acquisition of land and buildings** or the refinancing of debt incurred in its acquisition. Where business premises are to be constructed or significantly renovated, the 25-year maximum would be **in addition to** the time needed to complete construction. "Significant renovation" means construction costs of at least one-third of the current value of the property.

Where the loan proceeds are to be used for **varied purposes,** the **maximum** maturity and resulting amortization will be a **weighted average**.

Example:

Purpose	Amount	Percent of Total		Maximum Maturity	Maturity
Purchase Land/Bldg	$200.0	50%	X	25	12.50
Purchase M & E	$100.0	25%	X	10	2.50
Purchase Inventory	$ 40.0	10%	X	7	.70
Working Capital	$ 60.0	15%	X	7	1.05
Total	$400.0	100%			16.75

Maximum maturity: 17 years

MATURITY WHEN REFINANCING EXISTING ASSETS

The maximum maturity for a loan used to refinance either real estate or acquire fixed assets shall not exceed the remaining prudent economic life of the item(s) acquired with the proceeds of the loan being refinanced, up to 25 years.

Regardless of the maturity for refinancing existing fixed assets or real property, the loan analysis must justify that the asset(s) being refinanced have an economic life not shorter than the maturity provided.

INTEREST RATE

The interest rate on an SBA guaranteed loan is negotiated by the lender and borrower and may be **fixed** or **variable**, provided it is legal and reasonable and within SBA maximums. State law governs whether an interest rate is legal, and SBA maximums do not automatically exempt loans from state usury laws. Consult counsel to insure that interest rates are not usurious and for advice about circumstances that permit Federal loans to preempt state law in certain cases.

The **maximum rates*** under SBA guidelines are:

- 2.25 percentage points over "prime" on maturities less than 7 years

- 2.75 percentage points over "prime" on maturities of 7 years or more

* The only exception to the stated maximum rates is as follows: SBA will permit a lender to charge one percentage point (1%) higher on loans between $25,000 and $50,000 **AND** two percentage points (2%) higher on loans under $25,000. (Note: Lenders are not permitted to split loans into smaller loans in order to obtain a higher rate.)

FIXED RATE

The maximum fixed rate is based on the prime rate published in the Wall Street Journal on the day the guaranty request is received by SBA. If the prime rate is expressed as a range, the lower rate is used as the base.

VARIABLE RATE

The maximum variable rate is generally based on the Wall Street Journal prime, but **may** be based on the "optional peg" rate published quarterly by SBA in the Federal Register. This rate is an intermediate-term rate based on the U.S. Treasury's cost of funds and is generally lower than the WSJ prime.

Spreads: Once the spread has been established, it must remain the same throughout the term of the Note. When requested by the participant, SBA will permit a lender to limit the upward and downward fluctuations by establishing a floor and a ceiling provided that (1) both the ceiling and the floor are stated in the Note and (2) the difference between the stated rate in the note and the floor is equal to or greater than the difference between the stated rate in the Note and the ceiling. (For example, if the rate is 10% and the ceiling is 12%, the floor must be 8% or lower.)

Adjustment Interval: Lender must specify the frequency at which the rate adjustment will occur. The first adjustment can be the first day of the month following first disbursement. Subsequent adjustments may be at agreed upon intervals, but **no more often than monthly**, i.e., monthly, quarterly, semi-annually, annually or other suitable period. All dates of adjustment must fall on the first business day of the month of that adjustment period.

Effective Date of Adjustment: The interest rate on the loan will change on the first calendar day of the month (quarter, et al) even though the rate may not be determined until the first business day.

Calculation Basis: Interest should be calculated on a simple interest rate. On the date of initial disbursement, Lender must indicate on the Settlement Sheet, SBA Form 1050, what basis is to be used: i.e. either 30/360 or actual/365. Once a basis has been established, it cannot be changed for the life of the Note without SBA approval. Interest is calculated on the outstanding balance to the date of receipt of payment (not on an amortization table).

REPAYMENT TERMS

Various methods of amortizing loans are available, including the following:

- Principal and Interest uses equal periodic installments.

- Principal plus Interest uses a payment schedule that provides for installments of a fixed amount of principal plus the interest accrued for the payment period.

- Graduated Payments, either principal and interest OR principal plus interest can be used so that borrower is paying less in the start-up stages and more later after it has hopefully become more profitable.

- Interest Only, followed by one of the above three methods, is sometimes permitted for construction and/or cash flow purposes for start-up or expansions.

Balloon payments are not generally permitted; therefore, payments should be structured so that the loan is paid in full by the scheduled maturity date. If a loan is on a variable rate, then payments should be **reamortized** each time the interest rate fluctuates so that a balloon will not remain at maturity.

Generally, payments are on a monthly basis. However, other frequencies may be considered depending on the cash flow needs of the applicant business. Other acceptable frequencies are quarterly, semi-annually, annually, and seasonal. Frequencies other than monthly must be justified.

NOTE: PAYMENTS SHOULD ALWAYS BE ROUNDED TO THE NEAREST ONE DOLLAR!

COLLATERAL

Generally, an SBA loan must be secured as fully as possible with whatever assets are available to be pledged. Collateral and personal guarantees of the principals provide a secondary means of repayment if the borrower is unable to repay the debt from its cash flow. SBA will not decline a loan if the only weakness in the application is in collateral, provided that all assets available to the business and its principals have been pledged. Personal guaranties are required of any person owning 20% or more of the applicant (irrespective of the form of ownership) and the chief executive officer of the applicant (irrespective of the ownership interest in the business). If a member of management occupies a key position that is vital to repayment ability, a personal guaranty may be required regardless of his/her stock ownership. These guaranties might be secured or unsecured. Spouses may be required to sign limited guaranties where legal and appropriate, if they have an interest in collateral being pledged.

While cash flow is paramount to collateral in our analysis of repayment ability, it is important, nonetheless, to accurately calculate the real value of the collateral assets providing the secondary source of repayment, as this valuation will have an impact on the overall creditworthiness of the application.

A loan is considered to be fully secured if it has security interests in assets with a combined liquidation value that equals or exceeds the loan balance. Liquidation value of an asset means the amount expected to be realized if the lender sold the asset after conducting a reasonable search for a buyer and after deducting the costs of taking possession of the asset, preserving the asset and marketing the asset. Personal guarantees are not considered collateral unless they are secured with personally owned assets.

If a loan is not fully secured but the applicant and principals of the applicant have agreed to secure the loan with security interests in all available worthwhile assets, the loan may be approved if other credit factors are favorable. However, if a loan is not fully secured and there is available collateral which the applicant is unwilling to provide, the loan will be declined for having inadequate collateral.

When loan proceeds will be used to buy assets, the acquired assets must be used as collateral. When SBA refinances secured debts, we expect to have at least the same security. The first source of collateral is the assets of the business. If a collateral shortfall exists, look to the personal assets of the principals to secure their guarantees - first to investment properties and then to the personal residence.

PERSONAL RESIDENCE

A personal residence is taken as collateral when:

- The participant lender requires it; OR

- Other collateral offered is weak and the equity equals or exceeds 25% of the property's fair market value.

Since collateral is never a substitute for repayment ability, the liquidation of collateral should not be relied upon as a source of repayment. When a borrower lacks reasonable assurance of repayment from the earnings of the business, the loan will be declined.

Unless state law prevents it, owner-occupied residences may always be required as collateral where the applicant operates out of the residence or other buildings located on the same parcel of land. Residential properties and other buildings leased or rented to others may always be required as collateral. Where an owner-occupied residence is taken as collateral, no representations are to be made limiting the possibility of foreclosure in the event of default.

ASSIGNMENTS OF LEASE AND LANDLORD'S WAIVERS

An assignment of lease and landlord's waiver should be obtained when a substantial part of the loan proceeds are to be used for leasehold improvements or a substantial portion of the collateral consists of leasehold improvements, fixtures, machinery or equipment that is attached to leased real estate. Personal assets or other assets are acceptable, and possibly preferable, alternative collateral in place of leasehold improvements. The length of the lease and renewal options should, as a minimum, equal the maturity of the loan. The assignment of lease should require the lessor to provide a 60-day written notice of default to lender/SBA with an option to cure the default.

When a landlord's waiver and assignment of lease cannot be obtained, the applicant's credit factors must be reconsidered to determine if approval is warranted. Approval without the waiver and assignment may be feasible where:

- other collateral or secured guarantees are available in sufficient amount to reasonably protect the Agency's interest; OR

- a profitable business with established, sufficient cash flow to repay the proposed SBA loan and other fixed obligations is expanding.

VALUE OF FIXTURES AS COLLATERAL

Fixtures attached to real property generally become a part of the realty. If SBA does not have a lien on the real estate, recovery on the fixtures is unlikely. There is no problem in perfecting a lien when both the real estate and fixtures are to be taken as collateral.

Where a chattel of substantial value is affixed to leased real estate or to real estate subject to a prior lien, consult with counsel regarding the effect of an SBA lien on the property.

CURRENT ASSETS AS COLLATERAL

Blanket liens on current assets such as inventory and accounts receivable, generally offer little value at liquidation. Inventory is usually sold off to meet other expenses or to meet debts. Accounts receivable are hard to collect if a business fails. Encumbering these assets may hurt the ability of the borrower to obtain short-term financing.

INSURANCE AS COLLATERAL

Life or disability insurance is required only to protect SBA's interests in the event of the death or disability of a key person(s) critical to the success of the business or whose continued earning power is being relied upon in making the loan. Life or disability insurance may not be necessary where the collateral is sufficient or there is adequate depth and experience of management. Coverage should be set at the minimum amount and type necessary to protect the loan. Consider the impact of the cost of the insurance (whether whole life, term, or some other form) on the working capital and cash flow. Assignment of existing insurance coverage is acceptable if the individual offers it.

COMMERCIAL REAL PROPERTY

If the loan is secured by commercial real property, an appraisal for that property by a state licensed or certified appraiser is required when:

- the approved loan amount (gross amount) exceeds $250,000; OR
- the approved loan amount is $250,000 or less AND the appraisal is necessary for appropriate evaluation of creditworthiness.

Appraisals are generally required on residential properties only if they represent a major portion of the collateral liquidation value.

Title insurance is required on commercial real estate.

Either an Environmental Questionnaire (completed in detail indicating that the lender has checked all the appropriate agencies and records for information on possible contamination - signed by the applicant and Lender) **OR** a Phase I and/or Phase II audit is required for all commercial real estate. SBA will not approve or permit subsequent closing of a loan where contamination is evident.

NOTE: The Coastal Barrier Resources Act prohibits Federal expenditures or financial assistance to projects located on undeveloped Atlantic and Gulf of Mexico coastal barriers and undeveloped wet lands in the Great Lakes.

PURCHASE OF AN EXISTING BUSINESS

SBA may finance a change of ownership when the change will:

- promote the sound development of a small business, OR
- preserve the existence of a small business.

The change of ownership may be financed through purchase of 100% of the capital stock or purchase of the assets. This policy applies whether (1) the acquiring party is a current owner(s) of the business buying out all of the interests of the other shareholders or (2) the acquiring party owns no stock of the business being acquired and is purchasing 100% of the capital stock of the corporation from the existing owner(s), as long as the result of the loan is that the acquiring entity owns 100% of the business. The acquiring party may be an individual or any other legal entity. (See Special Circumstances section in the prior chapter for a detailed discussion on "Change of Ownership Between Family Members".)

For change of ownership transactions, provide to the SBA:

- Tax returns of seller for the previous 3 years, if available, or if seller has been in business for that period;

- Current Balance Sheet; AND

- Current Profit and Loss Statement

SBA will help the applicant pay the cost of inventory, market value of fixed assets based on an appraisal, and a reasonable amount of goodwill based on the information obtained from the tax return.

In computing goodwill from the tax returns,

<u>If a corporation, take:</u>

1. Officer's salary, interest expense and net profit for the last three years, average the total and divide by 2.
2. Result is the amount of allowable goodwill.

<u>If a proprietorship, take:</u>

1. Interest expense and net profit for the last three years, average the total and divide by 2.
2. Result is the amount of allowable goodwill.

To determine the selling price, add:

1. Cost of inventory
2. Market value of fixed assets
3. Allowable goodwill

Note: There has been an instance where consideration was given to the value of a lease that was on very good terms that borrower would be obtaining through the sale, but this is a little unusual.

HOW TO VALUE A BUSINESS

METHODS USED IN ESTIMATING THE VALUE OF A BUSINESS

- Discounted Future Earnings
- Capitalized Adjusted Earnings
- Adjusted Book Value
- Gross Revenue Multiplier
- Cash Flow Method

The value of a small business is based on future benefits to be gained by its owners. This is most often expressed as earnings or profit.

None of the valuation methods can be relied upon without comparison to the other methods. Discounted Future Earning and Capitalized Adjusted Earnings should be more reliable because they are based on the existing and projected income stream. The Adjusted Book Value method is not as reliable because it measures the value of the business assets. This might reflect the liquidation value rather than the "going concern" value. Other methods could be acceptable if the value is determined using verifiable available financial information and the method is argued successfully.

DISCOUNTED FUTURE EARNINGS [SBA has an Excel Spreadsheet to calculate value under this method**]**

This method is based on present and future earnings adjusted for inflation (10-year projection).

Interest paid and officers' compensation should be added back to net earnings to obtain present earnings.

Future earnings must be discounted to reflect a reasonable capitalization rate for a small business.

Example

First Step: Adjust Historical Earnings

	Last year
Net Profit	***50.0***
+Officer's salary	***+70.0***
+Discretionary expenses	***+30.0***
- New Owner salary	***-60.0***
Adjusted Profit	***90.0***

Second Step: Get the adjusted profits for 5 years then do a Weighted Average of the Adjusted Earnings.

Year	Earnings	Weight	Adjusted
1	$ 50	1	$ 50
2	$ 30	2	$ 60
3	$ 70	3	$ 210
4	$ 60	4	$ 240
5	$ 90	5	$ 450
Totals		**15**	**$1,010**
			/15
Average			**$ 67**

(rounded)

Third Step: Determine the discount rate.

Determine T-Bill Rate	7.0%
Determine Offset Risk Rate ✓ Establish rate of return based on risk factors ✓ Establish rate of return based on general economy	12.0%
Determine Offset Illiquidity Rate	6.0%
Total the Rates	**25.0%**

Fourth Step: Estimate growth, both real and inflationary (for this example, we are estimating a 5% growth rate).

Fifth Step: Multiply the estimated earnings for each year by the estimated growth rate until estimated earnings for the next **10** years are determined.

Sixth Step: Multiply the adjusted, weighted earnings by the estimated growth (1 plus the growth rate) to determine the estimated earnings for the first year.

Seventh Step: Using the Net Present Value Table (see Appendix 2-B), multiply the estimated earnings for each year by the factor for the discount rate for each respective year to determine the discounted value of future earnings.

Eighth Step: Total the discounted earnings.

Ninth Step: Determine the residual value by subtracting the growth rate from the discount rate and dividing the difference into the discounted earnings for year ten.

Tenth Step: Add the residual value to the total discounted earnings.

Year	Previous Year Earnings	Growth (1 = 5%)	Adjusted Earnings	Discount Factor (25%)	Net Present Value
1	67.0	1.05	70.4	0.80000	56.3
2	70.4	1.05	73.9	0.64000	47.3
3	73.9	1.05	77.6	0.51200	39.7
4	77.6	1.05	81.5	0.40960	33.4
5	81.5	1.05	85.6	0.32768	28.0
6	85.6	1.05	89.9	0.26214	23.6
7	89.9	1.05	94.4	0.20972	19.8
8	94.4	1.05	99.1	0.16777	16.6
9	99.1	1.05	104.1	0.13422	14.0
10	104.1	1.05	109.3	0.10737	11.7
Net Total					290.4
Residual					58.5
Total					**348.9**

CAPITALIZED ADJUSTED EARNINGS

This method is based on historical earnings for several years (preferably 5 years).

It requires adjustments to include a reasonable owner's (officer's) salary, deletion of large "one-time" expenses, and deletions of interest expense.

Adjusted earnings must be weighted (according to age) and averaged.

Average earnings must be divided by an appropriate capitalization rate.

This method can be flawed by large changes in earnings from year to year.

Example:

***First Step**:* Adjust Historical Earnings

	Last year
Net Profit	***50.0***
+Officer's salary	***+70.0***
+Discretionary expenses	***+30.0***
- New Owner salary	***-60.0***
Adjusted Profit	***90.0***

Second Step: Get the adjusted profits for 5 years then do a Weighted Average of the Adjusting Earnings

Year	**Earnings**	**Weight**	**Adjusted**
1 2 3 4 5	$ 50 $ 30 $ 70 $ 60 $ 90	1 2 3 4 5	$ 50 $ 60 $ 210 $ 240 $ 450
Totals		**15**	**$1,010**
			/15
Average			**$ 67**

(rounded)

Third Step: Calculate a Discount Rate

Determine T-Bill Rate	5.0%
Determine Offset Risk Rate ✓ Establish rate of return based on risk factors ✓ Establish rate of return based on general economy	12.0%
Determine Offset Illiquidity Rate	3.0%
Total the Rates	**20.0%**

Fourth Step: Take the weighted average of the adjusted earnings and divide by the discount rate.

Example:

$67/.20 = $335

<u>ADJUSTED BOOK VALUE (NET WORTH)</u>

To calculate this method, use the following formula:

Take the Book Value of net worth
- assets not acquired
+ liabilities not assumed
+ fair market value of assets acquired
+ <u>any net worth adjustments</u>
= **Adjusted Book Value**

Example:

Beginning Net Worth	$16.8
Less A/R over 90 days old	0.0
Plus liabilities not assumed	23.4
Plus increase in value of assets	106.4
Plus N/P to seller being forgiven	37.0
Value of Business	**$183.6**

Notes:

1. This method is not usually reliable because it only reflects the value of the business assets.

2. The value of a "going concern" is in its ability to generate profits for the owner.

GROSS REVENUE MULTIPLIER

This method is based on historical comparison of other businesses whose revenue and selling prices are known.

The method is not reliable without support from other methods.

Example:

Three years average revenue	$364.2
Gross revenue multiplier*	x .80
Value of Business	**$291.4**

* Appendix 2-C provides Gross Revenue Multipliers for selected industries

CASH FLOW METHOD

First Step: Identify available cash for debt service via rule of thumb, sources/uses, or any other acceptable method.

Net Profit prior FY	**10.0**
+Depreciation	**5.0**
= Adjusted Profit	**15.0**

***Second Step**:* Choose a reasonable maturity and market interest rate for the financing requested.

Fixed Asset Purchases	**10**
Working Capital	**7**
Average Maturity	**8.5**
Interest Rate	**12%**

***Third Step**:* Reverse-compute the amount of total funds that the cash flow can support given the maturity and interest rate chosen (using an amortization table or calculator).

Cash flow of $15,000 annually at 12% for 8.5 years is annual debt service for the total amount of $77,295.78 (computed on an annual payment basis) or $79,696.69 (computed on a monthly payment basis).

Cash flow valuation establishes a range of $77,000 to $80,000.

Exercise: Take a few minutes to answer questions related to "business valuation" situations described below.

Problem

Review the information on Paris Printing Company found in Appendix 2-D. In addition to the information supplied, the appraised value of the real estate is $125,000 and the appraised value of the machinery and equipment is $130,000. Also, the new owner will be drawing $25,000 in salary. In addition to the business purchase, the new owner wants an additional $15,000 for working capital.

1. What is the purchase price of the business?

2. What is the value of the business, using the following methods:

   a) Adjusted Book Value?

   b) Gross Revenue Multiplier (use the rule of thumb for the industry from our handout (Printing Ship, Commercial)?

   c) Capitalized Adjusted Earnings (use a 15% discount rate)?

   d) Discounted Future Earnings (use a 15% discount rate)?

   e) Cash Flow Method?

Answers to these questions are found in Appendix 2-D.

PREPARING THE PRO-FORMA BALANCE SHEET

Financial statements must be prepared in accordance with generally accepted accounting principles (GAAP). Financial statements may be audited, reviewed, or compiled.

In some instances, the financial statements of a **sole proprietor** may contain both personal and business accounts. In this case, a financial statement must be prepared which reflects the accounts of the **BUSINESS ONLY**.

A few businesses use the accrual method of accounting on its financial statements **and** the cash method of accounting on its tax returns. In this instance when statements are submitted using the cash method, they must be converted to the accrual method in order to properly analyze the financial condition of the business.

The pro-forma balance sheet is a projected picture of the business's financial condition after the proposed loan is made. To prepare the pro-forma, take the applicant's interim financial statement, which must be less than 90 days old upon receipt at SBA, and transfer the accounts to the **FIRST** column on the back of SBA Form 4-I; make adjustments to the "debit" section to reflect the use of the SBA/Bank loan proceeds and to the "credit" section to the reflect the current (principal only) and long-term portion of the SBA/Bank debt. Any other adjustments to the balance sheet accounts are to be reflected in the "debit" and "credit" sections, as appropriate. (**NOTE: the total debit adjustments must have equal, offsetting credit adjustments so that the final pro-forma balances**) The adjusted figures are then carried over to the "Pro-forma" column and the ratio analysis is based on the pro-forma.

Generally, assets are reflected on the balance sheet at cost less depreciation. Even if the actual appraised value is greater, you should not make any adjustment to the proforma. However, in your comments you should include statements regarding the higher value and what effect that change would have on the balance sheet, particularly the debt to net worth ratio.

The following is a list of some balance sheet items that must often be adjusted to create the pro-forma:

> **Accounts Receivable** - a credit should be made for any uncollectible accounts -- a detailed aging of accounts receivable, which must be dated the same as the interim financial statement, is required. A corresponding debit should be made to net worth.
>
> **Loans Due From Stockholders** – should be credited, debited to net worth.
>
> **Inventory** - should be credited for any obsolete inventory and debited to net worth.
>
> **Intangibles -** goodwill, patents, trademarks, covenants-not-to-compete, etc. are credited; these are generally considered worthless at liquidation even though they may have value to a going concern. A corresponding debit should be made to net worth.

Loans Due to Stockholders - debited from the liability section and credited to net worth (principals are required to execute a standby agreement).

Personal Assets/Liabilities - debited/credited.

Inter-company transactions - debited/credited.

See Appendix 2-E for Proforma examples.

REQUIRED RATIO ANALYSIS FORMULAS

PROFORMA RATIOS:

Current: $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

Quick: $\dfrac{\text{Cash + A/R}}{\text{Current Liabilities}}$

Days/ARTO: (1) $\dfrac{\text{Total Sales}}{\text{Accounts Receivable}} = \text{ARTO}$

(2) $\dfrac{365}{\text{ARTO}} = \text{Days}$

Days/ITO: (1) $\dfrac{\text{Cost of Goods Sold}}{\text{Inventory}} = \text{ITO}$

(2) $\dfrac{365}{\text{ITO}} = \text{Days}$

Days/APTO (1) $\dfrac{\text{Cost of Goods Sold}}{\text{Accounts Payable}} = \text{APTO}$

(2) $\dfrac{365}{\text{APTO}} = \text{Days}$

Sales/WC: (1) Current Assets - Current Liabilities = WC

(2) $\dfrac{\text{Total Sales}}{\text{WC (Working Capital)}}$

Debt/Worth: $\dfrac{\text{Total Debt}}{\text{Total Net Worth}}$

Gross Profit: Express as a % of total sales

Net Profit: Express as a % of total sales

WHAT DO THE RATIOS TELL US?

- ✓ The **CURRENT RATIO** is the general barometer of working capital adequacy. Generally, the higher the current ratio, the greater the "cushion" between current obligations and the firm's ability to pay them.

- ✓ The **QUICK RATIO** is an indicator of the firm's ability to raise cash quickly. Generally, any value of less than 1 to 1 implies a reciprocal "dependency" on inventory or other current assets to liquidate short-term debt.

- ✓ The **ACCOUNTS RECEIVABLE TURNOVER RATIO** is the measure of the firm's ability to convert its receivables into cash. The higher the turnover, the shorter the time between sale and cash collection.

- ✓ The **INVENTORY TURNOVER RATIO** is an indicator of the requirements for financing and the need for goods in the business. The ratio measures the number of times the inventory is turned over during the year. A high inventory turnover can indicate better liquidity or superior merchandising; conversely it can indicate a shortage of needed inventory for sales. A low inventory turnover can indicate poor liquidity, possible overstocking, obsolescence, or in contrast to these negative interpretations, a planned inventory buildup in the case of material shortages.

- ✓ The **ACCOUNTS PAYABLE TURNOVER RATIO** reflects the promptness of payment to suppliers. The higher the turnover of payables, the shorter the time between purchase and payment.

- ✓ The **DEBT TO WORTH RATIO** expresses the relationship between capital contributed by creditors and that contributed by owners. The higher the ratio, the greater the risk being assumed by the creditor. A lower ratio generally indicates greater long-term financial safety.

- ✓ The **SALES TO WORKING CAPITAL RATIO** reflects the ability to finance current operations. A low ratio may indicate an inefficient use of working capital while a very high ratio often signifies overtrading – vulnerable position for creditors.

RMA Averages. RMA should be used with great care as a GENERAL reference. There are always differences in mode of operation, local trade practices and economic environments.

WORKING CAPITAL ADEQUACY

What is Working Capital?

It is the excess of current assets over current liabilities. Working capital has a circulating nature, involving investment in short-term working assets which are temporary in nature and which are eventually converted to cash. The cycle is generally expressed as cash, inventory, accounts receivable, cash.

What is the Adequacy of Working Capital?

Working capital is adequate when the firm is able to meet the operational expenses of producing and selling the product or service and to pay current liabilities as they become due.

Adequate working capital is of major importance to most SBA borrowers. Many firms have failed before reaching their potential due solely to inadequate working capital. The working capital analysis formats on the following pages are excellent tools and should be regularly utilized.

If necessary, as in the case for most start-ups, you may also require the applicant to provide a detailed cash flow projection. Consider increasing the loan amount if the request does not provide sufficient working capital. Do not reduce a needed working capital portion of a loan merely to improve the debt-to-net-worth ratio or to reduce a collateral shortage.

Balance Sheet Analysis Method

WORKING CAPITAL NEED/LONG-TERM LOAN AMOUNT
BASED ON HISTORICAL DATA FOR EXISTING BUSINESSES

STEP 1: Cash Cycle Analysis

To determine the approximate cash cycle, calculate (**in days**) the Accounts Receivable Turnover, the Inventory Turnover, and the Accounts Payable Turnover. The approximation can be made using the **LAST FISCAL YEAR END BALANCE** or a **WEIGHTED AVERAGE OF SEVERAL YEARS**.

	Last FYE or Weighted Average
Accounts Receivable	____
Plus Inventory	____
Minus Accounts Payable	____
Equals Net Cash Cycle in Days	____

STEP 2: Working Capital Need

Net Sales Last Fiscal Year	$______________
Minus Net Profit (or Plus Loss)	$______________
Minus Depreciation/Amortization	$______________
Equals Net Cash Expenditure	$______________

Net Cash Expenditure Divided By 365 Equals Net Daily Cash Expenditure	$______________
Net Daily Cash Expenditure Times Cash Cycle in Days (from Step 1 above) Equals Working Capital Need	$______________

STEP 3: Loan Amount

Working Capital Need from Step 2 Equals Loan Amount	$______________

You can also compare the results to industry averages (i.e., RMA).

RMA Method

WORKING CAPITAL NEED/LONG-TERM LOAN AMOUNT
BASED ON PROJECTIONS FOR NEW OR EXPANDING BUSINESSES

When calculating the working capital needs of a new or an expanding firm, start with a realistic sales forecast and plug trade averages such as those published by Robert Morris Associates (RMA). These averages can be adjusted upward or downward depending on the situation.

STEP 1: Sales Projection

At revenues of $5,000,000 which of the following industries has the greatest working capital need?
A – Retail Hardware B – Retail Grocery C – Wholesale Grocery

STEP 2: RMA Averages

The following averages/industry standards were taken from RMA

Retail Hardware		**Retail Grocery**		**Wholesale Grocery**	
Cash (% of Total Assets)	4.5%	Cash (% of Total Assets)	8.8%	Cash (% of Total Assets)	5.5%
Gross Profit (% of Sales)	33.9%	Gross Profit (% of Sales)	21.8%	Gross Profit (% of Sales)	26.9%
Sales/AR	27.3	Sales/AR	40.7	Sales/AR	16.4
COGS/INV	2.8	COGS/INV	13.3	COGS/INV	9.4
COGS/AP	11.4	COGS/AP	29.6	COGS/AP	17.7
Sales/Total Assets	2.5	Sales/Total Assets	6.9	Sales/Total Assets	4.0

STEP 3: Compute Needs

The following amounts were computed using the RMA amounts listed above and rounded to thousands.

Cash	90.0	Cash	63.8	Cash	68.6
A/R	183.2	A/R	12.3	A/R	304.9
Inventory	1180.4	Inventory	294.0	Inventory	388.8
Less: A/P	- 289.9	Less: A/P	- 132.1	Less: A/P	- 206.5
Working Capital Need/Loan Amount	1163.7	Working Capital Need/Loan Amount	238.0	Working Capital Need/Loan Amount	555.8

The above reflects an additional amount to allow for the cash needs of the business. It is better to err a little on the high side than to provide an inadequate amount.

RMA Method (continued)

WORKING CAPITAL NEED/LONG-TERM LOAN AMOUNT
BASED ON PROJECTIONS FOR NEW OR EXPANDING BUSINESSES

STEP 4: Additional Amount for Start-Up

An additional sum should be provided to allow for the initial start-up phase. Based on the premise that a 6-month period is needed to reach full capacity, 3 months of cash operating expenses might be a reasonable amount.

RMA shows the following as a percentage of Sales:

Retail Hardware		**Retail Grocery**		**Wholesale Grocery**	
Operating Expenses	31.6%	Operating Expenses	21.2%	Operating Expenses	15.4%
Depreciation	1.1%	Depreciation	1.1%	Depreciation	.7%
	30.5%		20.1%		14.7%

Depreciation is subtracted from Operating Expenses since it is a non-cash item.

At revenues of $5,000,000, the amount needed for 3 months of cash operating expenses (rounded to thousands):

Retail Hardware		**Retail Grocery**		**Wholesale Grocery**	
Sales	$5,000.0	Sales	$5,000.0	Sales	$5,000.0
X	30.5%	X	20.1%	X	14.7%
1 Year Expenses	$1,525.0	1 Year Expenses	$1,005.0	1 Year Expenses	$735.0
3 Months	$381.3	3 Months	$251.3	3 Months	$183.8

The total amount needed is estimated as:

Retail Hardware		**Retail Grocery**		**Wholesale Grocery**	
Working Capital Needs	$1163.7	Working Capital Needs	$238.0	Working Capital Needs	$555.8
Start-Up Period	$381.3	Start-Up Period	$251.3	Start-Up Period	$183.8
Total	$1,545.0	Total	$489.3	Total	$739.6

SBA Method

WORKING CAPITAL NEED/SBA BASIC & OPTIONAL LOAN AMOUNTS

STEP 1: Cash Cycle Analysis

Perform Step 1 as in the Balance Sheet Method. You should generally use the last fiscal year-end, rather than the interim statement, for determining the turnovers. The weighted average method can be used as an alternative method.

STEP 2: Working Capital Need

Perform Step 2 as in the Balance Sheet Method.

STEP 3: Calculation of Basic Loan Amount Based on Historical Sales Data

This computation provides you with the basis for determining the current cash requirement (since the formula uses historical rather than projected sales). The following formula is to be used to arrive at a basic loan amount, not a mandatory amount.

Working Capital Need from Step 2	$______________
Less Existing Working Capital	$______________
Equals Basic Loan Amount	$______________

OR

STEP 3: Calculation of Optional Loan Amount Based on Projected Sales Data

If the projection of the business is to substantially increase sales and/or if loan maturity is going to be for more than one year, you may need to consider an optional loan amount (to cover future needs) which could be calculated as follows:

Working Capital Need from Step 2	$_______________
Last Fiscal Year Net Sales from Step 2	$_______________
1st Year Projected Sales	$_______________

Working Capital Need Divided by Last Fiscal Year Net Sales Equals	_______________%

1st Year Projected Sales Times % Above Equals Projected Working Capital Need	$_______________
Less Existing Working Capital	$_______________
Equals Optional Loan Amount	$_______________

Start-Up Formula For New Business:

For start-ups (or other businesses) which do not "fit" the above referenced working capital formulas, an acceptable alternative method for determining adequacy of working capital would be to:

(1) Total all operating expenses plus proforma payments for the next 12 months.

(2) Determine length of time until business should be generating adequate cash revenues.

(3) Divide total expenses by appropriate number (e.g., by 4 if they should be generating adequate cash in 3 months; by 2 if they should be generating adequate cash in 6 months).

(4) Evaluate whether the firm has sufficient working capital to carry through this initial period. If not, you may need to consider increasing the loan, requiring additional equity injection, or identifying other sources for additional working capital should it become necessary.

Breakeven Analysis:

(1) Total expenses (less depreciation & interest)

(2) Add all fixed debts (annualized payments including SBA loan)

(3) Divide results of #2 by the gross profit % (as a decimal)

Results of #3 will give you the necessary $ amount of sales that must be achieved in order for the business to breakeven.

Cash Flow Analysis:

Include all fixed debts (principal + interest)

Include net profit + depreciation + interest (+ rent if previously rented & are now purchasing)

Note: If sole proprietor, make sure owner's salary has been deducted before net profit.

IRS VERIFICATION

SBA policy mandates that IRS tax return information be used to verify the financial information submitted by small businesses to insure that SBA/Lenders are relying upon credible data when making credit decisions.

This policy is a major element in the Agency's effort to deter and detect fraudulent financial data submitted to SBA/Lenders. Approval of unqualified individuals and businesses inevitably results in an increase in defaulted loans and denies needed funding to individuals and businesses legitimately eligible for SBA's financial assistance.

It is the responsibility of Lenders (PRIOR TO LOAN CLOSING) to obtain verification from IRS of actual IRS tax return(s) filed against the tax return(s) or profit & loss statement(s) submitted with the loan application.

TAX RETURNS TO BE VERIFIED

All business tax returns submitted with loan applications must be verified. Verification must be acquired for all existing small business concerns and for any small business concern being acquired with loan proceeds. It does not apply to personal tax returns of principals/guarantors OR for newly established businesses (since tax returns would not have been submitted or evaluated).

FORM USED TO OBTAIN TAX RETURN INFORMATION FROM IRS

IRS Form 4506, Request for Copy or Transcript of Tax Form, **dated 5/97**, signed by the appropriate party (detailed in instructions for completion of form), is forwarded to IRS. A copy of Form 4506 is included as Appendix 2-F. Please use this to copy a supply for your use. Each Form 4506 should always have "SBA" printed on the top center of the form. That clearly identifies it as part of SBA's joint project with IRS.

WHEN TO REQUEST VERIFICATION FROM IRS

Verification should be requested at the earliest date a loan application appears likely. It is not necessary to wait until SBA approval has been received. Doing so could cause a delay in closing the loan. Note: IRS must receive the form within 60 days of the date it is signed.

WHERE TO OBTAIN TAX RETURN INFORMATION

The IRS has consolidated the processing of all Form 4506 tax verification requests, including requests for personal and business transcripts, in 10 IRS Service Centers. This consolidation should greatly simplify and expedite the tax verification process.

The IRS will provide an expedited 2-day tax transcript service for all bulk tax transcript requesters that require immediate or urgent tax transcript service. Due to the volume of SBA transcript requests and to the urgent nature of the Agency's expedited loan processing procedures, all SBA lender transcript requests will generally qualify for bulk/expedited service from the IRS.

The SBA and the IRS have also reached an agreement that SBA lenders may submit tax transcript requests to the IRS Service Center that is closest or most convenient to the lender or the taxpayer. This represents a significant change – Lenders will no longer be required to determine the county location of the taxpayer and then the corresponding IRS servicing office. The IRS Service Centers, their primary service areas, the responsible manager, and fax and voice telephone numbers are found in Appendix 2-G . (They are also listed on the reverse side of the Form 4506.) Requests may be express mailed or faxed to the Centers.

Please note that all transcript requests must be submitted using a properly signed and completed IRS Form 4506, Request for Copy or Transcript of Tax Form, revised May, 1997. **Each Form 4506 submitted for bulk and expedited processing must be marked with a large "B" on the top of the form.** Each form must also be carefully reviewed for completeness and accuracy - incomplete or inaccurate forms will be returned to the taxpayer with a notification to the requester/lender. (Return of the form to the taxpayer is an IRS mandated policy; however, the transcript data will be forwarded to the lender only.) The following critical items should also be particularly noted:

- Signature date must be included and must be current (IRS must receive the request within 60 days of signature date).
- Forms cannot be altered (i.e. crossed-out or changed dates, phone numbers, signatures, etc.).
- Current taxpayer address (taxpayer's address at time of filing) must match IRS records for the taxpayer.
- Telephone number of requester must be the telephone number of the taxpayer.

Where possible, lenders should consolidate and batch their requests, but no more than 50 requests should be included in each batch. (Bulk requesters may submit an unlimited number of batches per day.) Your transmittal of the bulk requests to IRS should list each taxpayer's name, taxpayer identification number, and the tax period(s) requested.

Requests for expedited transcripts may be faxed, couriered or express mailed (Federal Express, RPS, or other expedited services, including those of the U.S. Post Office) to the IRS using the fax numbers or addresses listed in Appendix 2-G. The IRS will respond, generally within 2 business days, but lenders should contact their respective IRS Centers to work out the method of IRS's response. In most instances, the IRS response will have to be mailed, either through the Postal Service or some other carrier, or it may be couriered. **Please note, however, that expedited mail or courier services for IRS responses will include charges that the IRS will be unable to absorb, so lenders should be prepared to work out carrier billing details with their respective IRS Centers**.

Telephone inquiries and transcript requests to IRS Centers should be limited to normal business hours, which for IRS are 7:30 AM to 4:00 PM local time, Monday through Friday. With the projected 2-day turnaround time, a request received by IRS before 4:00 PM on Monday, should be completed by close of business Wednesday.

Form 4506 should be sent to the Service Center under a cover memorandum (see sample memorandum in Appendix 2-H) explaining the purpose of the Form 4506, an address to which the tax data should be sent, and the name and telephone number of a Lender employee to contact should a question arise.

Computer generated transcripts of the requested sole proprietorship returns will be made available to he SBA/Lender. A transcript is a line-by-line summary of a tax return. The transcripts reflect 1040 data, Schedule C data, and other schedules submitted for sole proprietorships.

For partnerships or corporations, IRS will send you a form letter upon which it will enter certain corporate or partnership data (see sample IRS Letter in Appendix 2-I).

Delays in SBA related tax verifications are often the result of the IRS receiving Forms 4506 with remittances attached (there is currently no charge for SBA related verification requests) OR the failure to clearly note or identify SBA at the top of the form. Properly completed and appropriately addressed requests should help to greatly expedite the process.

INSTRUCTIONS FOR COMPLETION OF IRS FORM 4506

1a Name of first individual, corporate or partnership name as shown on tax form.

1b First social security number shown on tax form OR employer identification number.

2a If a joint return, spouse's name as shown on tax form.

2b Second social security number (spouse's number) shown on tax form.

3 Current name(s), (if different from what was given in 1a and 2a above), AND current address.

4 If a taxpayer's current address in Item 3 is different from the address when the last tax return was filed (and they have not changed their address with the IRS), the Lender should obtain from the taxpayer a piece of identification, other than a credit card, bearing the taxpayer's signature. A copy of the identification verification should be included with the request for processing. Do not submit the original.

5 Name, address and telephone number of the Lender (since verification must be sent back to Lender)

6 Leave BLANK

7 Leave BLANK

8 Check "a" (DO NOT check "b", "c", or "d")

9 Check "Small Business Administration" (DO NOT check "Department of Education", "Department of Veterans Affairs" or "Financial Institution")

10 Number of tax form to be verified (i.e. 1040, 1040A, 1040EZ, 1120, 1120A, 1120S, or 1065). Note: If an amended return was filed, you must request the amended form (i.e. 1040X) or you will receive the originally filed form, not the amended.

11 Tax years to be verified (i.e. 1994, 1995, 1996)

12 IRS is not currently requiring payment for the transcripts.

Form 4506 Signature Requirements:

Form 1040, 1040A, 1040EZ....by individual OR if joint return, either spouse may sign.

Form 1120, 1120A, 1120S....by President or Chief Executive Officer (CEO) of the corporation. The person's title must appear on the line below the signature. Any other corporate official having legal authority to bind the corporation may sign, but must attach a statement stating that fact on corporate letterhead stationery. Any other corporate officer or employee may sign, but must attach a written request signed by the President or CEO and attested to by another corporate officer.

Form 1065....by any person who was a member of the partnership during any part of the period covered by the tax return.

REVIEW OF TAX RETURN INFORMATION

Lenders are required to compare data received from IRS against information provided at the time of loan application. If your check reveals that they all conform, then you should include a summary of your evaluation in the loan file together with all the IRS data before disbursing the loan. When a significant discrepancy exists, the Lender must notify SBA and not disburse any loan proceeds unless, and until, the discrepancy is resolved. The Lender may inform the applicant that SBA halted disbursement pending its investigation of an adverse change but MAY NOT disclose that this is in reference to the IRS verification.

Without notifying the applicant, SBA must refer significant discrepancies to the Office of Inspector General (OIG) with a copy to the Director of the Office of Loan Programs. When a discrepancy is not resolved, the loan must be canceled due to an adverse change. The cancellation letter must clearly state that the reason for cancellation is the appearance of discrepancies between financial data submitted with the application and that received from IRS.

NOTE: If the lender does not receive a response or copy of the tax transcript within 10 business days, and the loan is ready for closing, the lender may proceed to close and disburse the loan without the IRS data. (If the loan is not ready for closing, the lender must follow-up with the IRS as described below.

If the loan is disbursed, the lender must continue to follow-up with the IRS to obtain and verify the tax data. The lender must resubmit a copy of the Form 4506 to the IRS with the notation “Second Request” in the top right hand corner and must document the loan file with a dated copy of the second transmittal to the IRS.

Upon receipt of the IRS transcript data, the lender must check and verify the data against the financial information submitted in support of the SBA loan application. If no material discrepancy exists, the IRS data must be retained in the loan file along with documentation as to the date of receipt and analysis completed.

If a material discrepancy appears or if the IRS advises that it has no record on the applicant, the lender must report it immediately to the cognizant SBA office and document the loan file of the action taken. The SBA may direct the lender to rescind approval of the loan (if no disbursement has occurred), suspend further disbursement, call the loan, or initiate recovery of any disbursed amounts. In addition, SBA will refer the matter to OIG’s Investigations Division.

If the loan defaults, and the lender has not made other material errors, the SBA will honor the guarantee provided the lender has followed the above procedures, exercised prudent judgment and the loan file is properly documented.

SBA is continuing to work with the IRS to streamline the tax verification process within IRS. Lenders may document all recurring or systemic problems or delays with specific IRS offices and forward that information to Charlie Thomas by fax at 202-205-6656.

ENVIRONMENTAL CONSIDERATIONS

SBA requires an investigation and assessment of the environmental risk on all primary collateral offered as security for any loan or debenture that the Agency is asked to guaranty in order that the risks of environmental contamination can be assessed and addressed. A lender may require its own environmental investigation of any additional collateral at its discretion.

A. WHAT ARE THE RISKS OF ENVIRONMENTAL CONTAMINATION?

(1) The costs of remediation could impair the borrower's ability to repay the loan.

(2) The value and marketability of the property could be diminished. If the borrower defaults, SBA might have to abandon the property to avoid liability or accept a lower than expected price.

(3) The SBA potentially could be liable for environmental clean-up costs and third-party damage claims arising from environmental contamination if it takes title to contaminated property as a result of foreclosure proceedings or if it exercises operational control over the site.

(4) If a government agency cleans a site, it may be able to file a lien for recovery of its costs that may be superior to SBA's lien.

B. DEFINITIONS

(1) **Environmental Investigation** - An investigation to help ascertain whether and the degree to which a property is subject to environmental contamination. An Environmental Investigation may include one or more of the following: an Environmental Questionnaire, Transactional Screen Analysis, Phase I Audit, and Phase II Audit, as these terms are defined below.

(2) **Environmental Questionnaire** - A written form asking specific environmentally related questions about the property which requires a visual inspection to complete the form. The lender or its agent must complete it after conducting an interview with the current owner or operator of the site and the current owner or operator of the site must sign it. The lender may use SBA's form or its own form if it includes all of the information included in SBA's questionnaire.

Use of an environmental questionnaire consistent with the standard issued by the American Society for Testing and Materials is satisfactory to SBA.

(3) **Environmental Records Review** - A review of the files of the regulatory agency (defined below) related to environmental permits, reported contamination, and the storage, generation, transportation, use, or release of environmentally harmful substances at the site or at nearby properties. These records may be available from

the appropriate governmental agencies, and there are commercial services available to obtain this information, including several on the Internet. The Environmental Records Review must include, at a minimum, the following databases and minimum search distances to the subject property:

Governmental Record	Approximate Minimum Search Distance
Federal NPL site list	property and 1.0 miles
Federal CERCLIS list	property and .5 miles
Federal RCRA TSD	facilities list property and 1.0 miles
Federal RCRA generators list	property and adjoining properties
Federal ERNS list	property
State equivalent of NPL list	property and 1.0 miles
State equivalent to CERCLIS list	property and 1.0 miles
State landfill and solid waste disposal site list	property and .5 miles
State leaking underground storage tanks list	property and .5 miles
State registered underground storage tanks list	property and adjoining properties

(4) **Historical Records** - A second component of the Environmental Records Review consists of such items as: Aerial Photographs that show the development and activities on the subject property and surrounding areas; Fire Insurance Maps that indicate the uses of the subject property and surrounding areas; local fire, health, or environmental departments public records that show the uses of the subject property and surrounding areas; and any other records which could provide insight into the uses of the subject property and surrounding areas such as zoning records, building permits, property tax reports, and land title records.

(5) **Lender** - refers to banks, non-bank lenders, and certified development companies.

(6) **Monitoring** - A physical sampling of soil or groundwater to determine the continued presence or quantity of environmental contamination.

(7) **No Further Action Letter** - A statement issued by the regulatory agency declaring that no further remediation or monitoring of contamination previously found is required.

(8) **Phase I Audit** - An investigation and written report by an environmental professional regarding the history and use of the property, which determines the potential existence of environmental contaminants. At a minimum, a Phase I Audit must contain all of the following elements:

(a) A visual inspection of the site and adjacent properties;

(b) An Environmental Records Review;

(c) On-site review of available environmental records and interviews with the current owner and (if different) operator of the site and others with knowledge about operations on the site and on adjacent sites, such as the previous owner and (if different) operator of the site, and owners or operators of neighboring sites; and

(d) A conclusion by the contractor that performs the audit either: (i) that the risk of contamination at the site is so minimal that no further investigation is warranted; or (ii) that there is risk sufficient to warrant additional investigation.

(9) **Phase II Audit** - An investigation and written report conducted by an environmental professional involving testing for actual contamination which relies on laboratory testing of samples extracted from potentially contaminated locations (buildings, soil or groundwater) to determine whether and to what extent actual contamination exists.

(10) **Primary Collateral**

(a) The project site that is acquired or improved through the loan proceeds; OR

(b) Any business real property to be taken as collateral when it represents over 50 percent of the total collateral value.

(11) **Reasonable and Prudent Belief That There Is No Risk of Contamination** - A belief based on existing information and prudent lending standards that past business or agricultural operations at the Primary Collateral site or on adjacent sites are unlikely to have resulted in contamination at the site. Such a determination would not be reasonable if:

(a) There is insufficient knowledge about past or current business or agricultural operations at the site or adjacent sites to be able to reach such conclusion; OR

(b) Past or current business or agricultural operations at the site or adjacent sites are likely to have involved the use of (i) chemicals in such quantities as would be subject to regulation by environmental authorities or (ii) aboveground or underground storage tanks. Likelihood of contamination may arise from the known business operations at the site or typical industry practices of any business that operated at the site or adjacent sites.

(12) **Regulatory Agency** - The local, State, or Federal agency with authority to enforce environmental laws regarding use of hazardous materials or cleanup of environmental contamination at the primary collateral site.

(13) **Remediation** - Any action to clean-up or remove contamination from soil at a site or groundwater under a site.

(14) **<u>Transactional Screening Analysis ("TSA")</u>** - A review and written report which includes the following.

(a) A visual inspection of the site being offered as collateral by a person trained to determine whether conditions at a site are indicative of potential environmental contamination or adverse environmental conditions. The person conducting this inspection may be an employee of the lender or its agent, but cannot be an employee of, or under contract with, the seller, the borrower or any other party that will benefit financially from the loan. The lender must use prudent lender standards in choosing or accepting the qualifications of the person conducting the inspection.

(b) The completion of an Environmental Questionnaire.

(c) An Environmental Records Review.

(d) A recommendation by the lender or its agent either: (i) that the risk of contamination at the site is so minimal that no further investigation is warranted; or (ii) that there is risk sufficient to warrant additional investigation.

C. <u>ENVIRONMENTAL INVESTIGATION REQUIREMENTS</u>

Environmental investigation is part of the due diligence required of lenders.

(1) Except for loans of $25,000 or less, there must be an Environmental Investigation for all business loan applications secured by Primary Collateral. The results of this Environmental Investigation must be sent to SBA.

(2) Due diligence and prudent lending practice require a lender to pursue more in-depth investigation when an investigation method indicates a risk of environmental contamination. The type of Environmental Investigation to be performed varies with the amount of the risks described in Paragraph A of this section which might result from any contamination that might be present. The greater the risk, the more in-depth should be the investigation.

(3) If a loan application is for $25,000 or less, no Environmental Investigation is required if the borrower certifies in writing that he or she has no knowledge of any past or present contamination at the site and lender has no information to the contrary.

D. <u>THE STEPS OF AN ENVIRONMENTAL INVESTIGATION</u>

Depending on the circumstances, the Environmental Investigation can begin with an Environmental Questionnaire, Transactional Screening Analysis, Phase I Audit or Phase II Audit.

(1) The Environmental Investigation may begin with an Environmental Questionnaire when any of the following five conditions exists:

(a) There have been no business or agricultural operations on the property;

(b) The collateral is part of a multi-unit building or complex;

(c) A Phase I Audit has been completed within 1 year of the loan application indicating that the risk of contamination at the site is so minimal that no further investigation is warranted;

(d) A Phase I Audit has been completed within one year indicating the presence of contamination and: (i) the Regulatory Agency has determined that no remediation or monitoring is necessary, or that remediation and monitoring has been completed; or (ii) an adequate indemnification agreement exists; OR

(e) There is a Reasonable and Prudent Belief That There Is No Risk of Contamination as specifically defined in subparagraph b. (11) of this paragraph. If this belief does not exist, a TSA would be appropriate [see subparagraph d. (2) of this paragraph].

If the Environmental Questionnaire or other information available indicates a risk of environmental contamination, the loan cannot be disbursed. Therefore, further investigation such as a TSA or Phase I Audit will be required.

(2) The Environmental Investigation may begin with a TSA when the lender, or CDC for 504 loans, is unable to conclude that there is a Reasonable and Prudent Belief That There Is No Risk of Contamination, based on the due-diligence it has already completed.

If the TSA indicates a risk of environmental contamination, the lender should either decline the loan or require a Phase I Audit prior to any disbursement.

(3) The Environmental Investigation may begin with a Phase I Audit when the lender, or CDC for 504 loans, has a reasonable belief that, based on existing information and prudent lending standards, the Primary Collateral site is likely to have been contaminated from past business operations at the site or adjacent sites. The likelihood of such contamination may arise from the known business operations at the site or adjacent sites, or from the typical industry practices of the business(es) which operated at the site or adjacent sites.

If the Phase I Audit indicates more than minimal risk of environmental contamination, the loan officer must either decline the loan or require a Phase II Audit to determine whether there is actual contamination.

(4) A Phase II Audit may be used when:

(a) A Phase I Audit reveals more than a minimal risk of environmental contamination; and/or

(b) A Phase II Audit will ultimately be needed and the Phase I Audit would be an unnecessary expense.

If an applicant cannot or will not obtain a Phase I or II audit when one is required, you may not approve or disburse the loan.

If a Phase II Audit indicates that contamination exists, the Audit must state: (i) whether the quantity exceeds the reportable or actionable levels for that contaminant established by the responsible Regulatory Agency; (ii) whether environmental remediation or monitoring of conditions will be necessary; and (iii) a general estimate of the remediation or monitoring costs.

E. WHAT IS THE TIMING FOR THE ENVIRONMENTAL INVESTIGATION?

A lender should initiate an Environmental Investigation as soon as it receives any application to be secured by Primary Collateral. The lender should get an understanding of the environmental issues surrounding any Primary Collateral before it applies to SBA for a guarantee. The lender must submit the results of its Environmental Investigation to the SBA office processing the application, prior to disbursement. SBA will approve disbursement based on the results of the Investigation it receives.

F. WHAT ACTIONS CAN BE TAKEN WHEN CONTAMINATION IS PRESENT?

If the Environmental Investigation indicates potential contamination, the lender should attempt to minimize the risks discussed in Paragraph A of this section from any such contamination before submitting the guarantee request to SBA. The processing office may approve the loan, with appropriate conditions, if it determines that the risk from potential environmental contamination is sufficiently minimized so that disbursement would be appropriate relying upon the factors below and in Paragraphs G and H of this section.

If the lender cannot minimize such risks sufficiently before it applies to SBA, the processing office may approve the loan, with appropriate conditions, if there is a reasonable expectation that the risks can be minimized sufficiently under the guidelines and relying upon the factors below and in Paragraphs G and H of this section.

A lender must submit documentation with its guarantee request of the actions taken and factors relied upon to minimize any such risk. If a lender does not submit this documentation with the guarantee request, it must do so prior to disbursement. In either case, the SBA processing office must concur that the risks have been sufficiently minimized.

The SBA processing office may approve disbursement if the contamination issue is resolved in any of the following ways:

(1) The amount of contamination present is less than the minimum "state action levels" set by the Regulatory Agencies and no remediation will be necessary under law;

(2) The Regulatory Agency has issued a "No Further Action" letter;

(3) There is adequate indemnification as discussed in Paragraph G of this section; or

(4) Guided by the factors discussed in Paragraph H of this section, disbursement is appropriate before completion of any necessary remediation or monitoring.

G. INDEMNIFICATION AGREEMENTS

A loan may be disbursed if the seller (or another party) possesses sufficient financial resources to cover the cost of completing remediation and signs an indemnification agreement that provides adequate protection to SBA and the lender. A standard indemnification agreement that field offices and lenders may use without authorization from Headquarters is included in Appendix 2-J. If the indemnifying party will not sign this standard agreement, but is willing to negotiate a different agreement, the processing office must refer the matter to the AA/FA who will consult with the Associate General Counsel for Litigation in determining its acceptability.

Attempt to obtain an indemnification agreement before considering the factors in Paragraph H of this section.

H. DISBURSEMENT BEFORE COMPLETION OF CLEAN-UP

The SBA office which processed and approved the loan will consider and approve the initial disbursement of this loan prior to the completion of remediation or monitoring (in the absence of a "no further action" letter or indemnification agreement) **if, and only if**, it is satisfied that the risks from any contamination or potential contamination as detailed in Paragraph A of this section have been sufficiently minimized. The SBA will rely upon one or more of the following factors when deciding to disburse before completion of remediation or monitoring:

(1) If the Regulatory Agency has affirmed in writing that remediation is complete but additional monitoring is required, approval may be granted after obtaining the monitoring results for the first year and a written opinion from a qualified environmental professional that the results show no unacceptable increase in contamination since remediation.

(2) Federal statutes limit the liability of lenders for contamination if the lender does not participate in the management of the site and moves promptly to sell the property after foreclosure. However, state law may hold the lender liable. If state law does limit environmental liability of lenders, field counsel should consult with the

Associate General Counsel for Litigation in making the determination that the law adequately protects SBA. In order to do so, state law should:

(a) Protect private lenders and governmental entities;

(b) Apply to the contaminants found at the site;

(c) Allow a lender to foreclose without creating liability; and/or

(d) Define specific circumstances under which a lender would be liable (for example a precise explanation of "not participating in management").

(3) If there is a satisfactory agreement or "comfort letter" from the Regulatory Agency stipulating that lender, SBA, and future purchasers would not be liable for specified contamination at the site, disbursement may be appropriate. This letter or agreement must be approved by an official authorized to bind the Regulatory Agency to its content.

(4) If the extent of contamination and cost of remediation is minimal in relation to the value of the property and/or the resources of the party responsible for remediation, approval, or disbursement may be considered if remediation is projected to be completed within a year. A discussion of the reliability of the remediation estimates and projected completion date should include the contractor's experience, the lender's confidence in or past experience with the contractor, and the nature of the contamination. This factor would be more appropriate for contamination affecting the soil, given the complexities of groundwater contamination.

(5) If the State in which the site is located has a fund to reimburse remediation costs and SBA is adequately protected, approval or disbursement may be considered. Any conditions of remediation that might preclude reimbursement, and the financial capability of the fund should be addressed. Written assurance from the responsible Regulatory Agency that the fund will apply to the specific site may be necessary.

(6) If an escrow account is available which equals 110 percent of the total estimated cost (in the bid or contract) of required remediation, controlled by the 7(a) lender or first mortgage holder in a 504 loan as trustee, approval of disbursement may be justified. The lender's role as trustee of this account is not to control or manage the property to be remediated, but solely to release funds from the escrow account upon the satisfactory completion of work by the contractor performing the remediation and/or monitoring.

The authorization must ensure that funds will only be used for costs of cleanup and remediation until the appropriate "No Further Action" letter is received. The Regulatory Agency must concur with the scope of remediation and the cost estimate should be reviewed for reasonableness including a discussion of the contractor's experience.

(7) If the borrower obtains a bond or insurance equal to 110 percent of the total estimated cost (in the bid or contract) of remediation, approval or disbursement may be considered. You must be satisfied that the borrower's cash flow is sufficient to complete the remediation and repay outstanding debt. The Regulatory Agency must concur with the scope of remediation and the cost estimate should be reviewed for reasonableness including a discussion of the contractor's experience.

(8) If groundwater contamination on the site is shown to have come from nearby property, approval may be considered if:

(a) Another party with sufficient resources is performing remediation and is willing to provide indemnification and the Regulatory Agency concurs with the remedial action;

(b) The State has a written policy that it will not hold an owner or operator of property responsible for contamination from another site; or

(c) The Regulatory Agency provides satisfactory written assurance that it will not hold the borrower, lender, SBA, or any future purchaser liable for the contamination.

(9) Additional or substitute collateral, or equity contribution, sufficient to overcome the potential loss due to contamination is available.

The lender must consider the following six information items when making a recommendation under this paragraph for approval or initial disbursement:

1) How the relied upon factors of Paragraph H sufficiently protect SBA from the risks resulting from contamination;

NOTE: There may be factors other than the nine referenced above which can be acceptable to SBA, but reliance upon any such factor not previously referenced requires clearance from the AA/FA (this includes PLP and PCLP/CDC lenders).

2) Nature and extent of contamination present (referring to relevant pages in the Phase I or Phase II Audit);

3) The status of remediation and monitoring;

4) Relevant environmental reports;

5) Correspondence from the Regulatory Agency regarding current conditions at the site; and

6) Amount of theloan.

Lenders should forward their justification for approval and/or disbursement to the SBA processing office responsible for making the approval/declination decision on the request for financial assistance.

I. SUBMISSION OF ENVIRONMENTAL INVESTIGATION TO SBA

When SBA approves a loan with the condition that initial disbursement cannot occur without SBA's approval, the results of the lender's Environmental Investigation must be reviewed by the SBA office which processed the application. The lender must submit sufficient justification for disbursement to SBA, based upon one or more of the factors referenced in Paragraphs F, G, and H of this section. Upon SBA approval, the lender may disburse the loan.

J. STANDARDS AND CRITERIA FOR THE SELECTION OF ENVIRONMENTAL CONTRACTORS

(1) Environmental audits must be performed or approved by contractor personnel with adequate expertise and independence. Such expertise is evidenced by:

(a) A license to conduct such an audit by the State in which the audit will take place;

(b) At least 5 years experience in conducting environmental audits;

(c) An advanced degree in engineering, environmental sciences, or geology and at least 2 years of direct experience in conducting environmental audits; OR

(d) Sufficient prior, satisfactory experience with the 7(a) lender or first mortgage holder on a 504 in conducting reliable and technically sound audits.

(2) In addition, a Phase I or Phase II Audit must be conducted by a firm that is impartial, with no conflict of interest in the transaction. The lender must obtain the responses from the auditor to the following information:

(a) Name and address of the contractor;

(b) Name and title of the person performing the audit plus a statement of how long the person has been performing environmental assessments and the education and training the person has received;

(c) The recognized environmental standards to be used in the audit;

(d) Any present or prior affiliation of the contractor with the seller or purchaser of the property;

(e) A description of the contractor's liability insurance; and

(f) A certification under 18 U.S.C. § 1001 that the information provided is true and correct.

The lender must include the contractor’s responses to these information requests when submitting a Phase I or Phase II audit as part of the justification for approval or disbursement.

APPENDIX 2-A

ANSWERS TO CHAPTER 2 REFINANCE EXERCISE

Refinancing Situations

1. A business has $200M in debt paying @ $17,000/month. It needs $300M more in M&E financing. Terms offered by lender are $500M for 5 years @ $10,600/month. Can SBA guaranty loan provide this credit?

   YES: $200M over 5 years = $4,240/month for that portion repaying the original debt. This is a reduction of $12,760/month, or 75% improvement over the original payment.

2. In the situation above, the original debt is paying @ $5,250/month. Now is it eligible?

   NO: Original $5,250 - new $4,240 = $1,010. This difference is only 19% of the original payment (1,010/5,250).

1. A different business has $300M of existing debt in two notes. Note 1 is for $200M paying @ $5,250/month. Note 2 is for $100M paying @ $3,350/month. The business needs $300M more. Can an SBA guaranteed loan finance the entire $600M new loan at desired terms of 5 years paying @ $12,750?

   YES:

   On the 5 years/$12,750 payment basis, the $200M note would result in a new payment of $4,250; the $100M note would result in a new payment of $2,125.

   Total $300 debt: Existing $8,600 - new $6,375 = $2,225 improvement = 26%

   For the $200: Existing $5,250 - new $4,250 = $1,000 difference = 19%
   For the $100: Existing $3,350 - new $2,125 = $1,225 difference = 36%

   The aggregate debt payment meets the 20% rule.

APPENDIX 2-B

NET PRESENT VALUE TABLE

NET PRESENT VALUE TABLE

	10.00%	*11.00%*	*12.00%*	*13.00%*	*14.00%*	*15.00%*	*16.00%*	*17.00%*	*18.00%*	*19.00%*	*20.00%*
1st	.90909	.90090	.89286	.88496	.87719	.86957	.86207	.85470	.84746	.84034	.83333
2nd	.82645	.81162	.79719	.78315	.76947	.75614	.74316	.73051	.71818	.70616	.69444
3rd	.75131	.73119	.71178	.69305	.67497	.65752	.64066	.62437	.60863	.59342	.57870
4th	.68301	.65873	.63552	.61332	.59208	.57175	.55229	.53365	.51579	.49867	.48225
5th	.62092	.59345	.56743	.54276	.51937	.49718	.47611	.45611	.43711	.41905	.40188
6th	.56447	.53464	.50663	.48032	.45559	.43233	.41044	.38984	.37043	.35214	.33490
7th	.51316	.48166	.45235	.42506	.39964	.37594	.35383	.33320	.31393	.29592	.27908
8th	.46651	.43393	.40388	.37616	.35056	.32690	.30503	.28478	.26604	.24867	.23257
9th	.42410	.39092	.36061	.33288	.30751	.28426	.26295	.24340	.22546	.20897	.19381
10th	.38554	.35218	.32197	.29459	.26974	.24718	.22668	.20804	.19106	.17560	.16151
11th	.35049	.31728	.28748	.26070	.23662	.21494	.19542	.17781	.16192	.14757	.13459
12th	.31863	.28584	.25668	.23071	.20756	.18691	.16846	.15197	.13722	.12400	.11216
13th	.28966	.25751	.22917	.20416	.18207	.16253	.14523	.12989	.11629	.10421	.09346
14th	.26333	.23199	.20462	.18068	.15971	.14133	.12520	.11102	.09855	.08757	.07789
15th	.23939	.20900	.18270	.15989	.14010	.12289	.10793	.09489	.08352	.07359	.06491
16th	.21763	.18829	.16312	.14150	.12289	.10686	.09304	.08110	.07078	.06184	.05409
17th	.19784	.16963	.14564	.12522	.10780	.09293	.08021	.06932	.05998	.05196	.04507
18th	.17986	.15282	.13004	.11081	.09456	.08081	.06914	.05925	.05083	.04367	.03756
19th	.16351	.13768	.11611	.09806	.08295	.07027	.05961	.05064	.04308	.03670	.03130
20th	.14864	.12403	.10367	.08678	.07276	.06110	.05139	.04328	.03651	.03084	.02608
21st	.13513	.11174	.09256	.07680	.06383	.05313	.04430	.03699	.03094	.02591	.02174
22nd	.12285	.10067	.08264	.06796	.05599	.04620	.03819	.03162	.02622	.02178	.01811
23rd	.11168	.09069	.07379	.06014	.04911	.04017	.03292	.02702	.02222	.01830	.01509
24th	.10153	.08170	.06588	.05323	.04308	.03493	.02838	.02310	.01883	.01538	.01258
25th	.09230	.07361	.05882	.04710	.03779	.03038	.02447	.01974	.01596	.01292	.01048

NET PRESENT VALUE TABLE

	20.00%	*21.00%*	*22.00%*	*23.00%*	*24.00%*	*25.00%*	*26.00%*	*27.00%*	*28.00%*	*29.00%*	*30.00%*
1st	.83333	.82645	.81967	.81301	.80645	.80000	.79365	.78740	.78125	.77519	.76923
2nd	.69444	.68301	.67186	.66098	.65036	.64000	.62988	.62000	.61035	.60093	.59172
3rd	.57870	.56447	.55071	.53738	.52449	.51200	.49991	.48819	.47684	.46583	.45517
4th	.48225	.46651	.45140	.43690	.42297	.40960	.39675	.38440	.37253	.36111	.35013
5th	.40188	.38554	.37000	.35520	.34111	.32768	.31488	.30268	.29104	.27993	.26933
6th	.33490	.31863	.30328	.28878	.27509	.26214	.24991	.23833	.22737	.21700	.20718
7th	.27908	.26333	.24859	.23478	.22184	.20972	.19834	.18766	.17764	.16822	.15937
8th	.23257	.21763	.20376	.19088	.17891	.16777	.15741	.14776	.13878	.13040	.12259
9th	.19381	.17986	.16702	.15519	.14428	.13422	.12493	.11635	.10842	.10109	.09430
10th	.16151	.14864	.13690	.12617	.11635	.10737	.09915	.09161	.08470	.07836	.07254
11th	.13459	.12285	.11221	.10258	.09383	.08590	.07869	.07214	.06617	.06075	.05580
12th	.11216	.10153	.09198	.08339	.07567	.06872	.06245	.05680	.05170	.04709	.04292
13th	.09346	.08391	.07539	.06780	.06103	.05498	.04957	.04473	.04039	.03650	.03302
14th	.07789	.06934	.06180	.05512	.04921	.04398	.03934	.03522	.03155	.02830	.02540
15th	.06491	.05731	.05065	.04481	.03969	.03518	.03122	.02773	.02465	.02194	.01954
16th	.05409	.04736	.04152	.03643	.03201	.02815	.02478	.02183	.01926	.01700	.01503
17th	.04507	.03914	.03403	.02962	.02581	.02252	.01967	.01719	.01505	.01318	.01156
18th	.03756	.03235	.02789	.02408	.02082	.01801	.01561	.01354	.01175	.01022	.00889
19th	.03130	.02673	.02286	.01958	.01679	.01441	.01239	.01066	.00918	.00792	.00684
20th	.02608	.02209	.01874	.01592	.01354	.01153	.00983	.00839	.00717	.00614	.00526
21st	.02174	.01826	.01536	.01294	.01092	.00922	.00780	.00661	.00561	.00476	.00405
22nd	.01811	.01509	.01259	.01052	.00880	.00738	.00619	.00520	.00438	.00369	.00311
23rd	.01509	.01247	.01032	.00855	.00710	.00590	.00491	.00410	.00342	.00286	.00239
24th	.01258	.01031	.00846	.00695	.00573	.00472	.00390	.00323	.00267	.00222	.00184
25th	.01048	.00852	.00693	.00565	.00462	.00378	.00310	.00254	.00209	.00172	.00142

APPENDIX 2-C

GROSS REVENUE MULTIPLIER FOR SELECTED INDUSTRIES

GROSS REVENUE MULTIPLIER FOR SELECTED INDUSTRIES

INDUSTRY	*RULE OF THUMB*
Accounting Practices	.75 to 1.5 times the current 12 months net revenue plus the value of tangible assets.
Apparel Stores	4 to 5 times average monthly net sales.
Auto Body Repair Shops	2 to 5 times average monthly net sales.
Automobile Dealerships	1.25 to 2 times current 12 months net operating profit plus the net tangible asset value.
Auto Parts Retailers and Jobbers	.25 to 1 times annual net operating profit plus the value of the fixed assets.
Beauty Salons	4 times average monthly net revenue.
Bicycle Shops	3 to 5 times average monthly net sales.
Bowling Centers	1 to 1.5 times most recent 12 months net revenue excluding food (not liquor) sales.
Building Material Retailers	.05 to .08 times the latest 12 months net sales plus the value of fixed assets.
Carwashes	3 times the latest annual net revenue plus the value of the real property.
Cocktail Lounges	4 to 9 times average net monthly net sales.
Coffee Shops.	4 to 5 times average monthly net sales.
Coin-Operated Laundries	14 to 16 times average monthly net sales.
Dental Practices	.75 to 1.25 times average annual net revenue.
Drug Stores	6 to 7 times most recent years net operating profit.
Dry Cleaners	12 times the average monthly net sales if plant is on premises; 3 to 4 times monthly net sales if no plant.
Fast Food Franchises	5 to 9 times average monthly net sales.
Florist Shops	.4 to .5 times the average net annual sales.
Funeral Parlors	.7 to .8 times most recent 12 months revenue plus the value of fixed assets.
Gasoline Stations	1.5 to 3.5 times most recent annual net operating profit.
Grocery Stores	3 to 4 times average monthly net sales.
Health Clubs	1.5 to 2.0 times most recent 12 months net revenue.
Insurance Brokers	1.5 times most recent 12 months net renewal commissions
Liquor Stores	4 to 5 times average monthly net sales.
Manufacturers Sales Reps.	2 to 5 times most recent 12 months adjusted net operating profit (before owner's salary and income tax) plus value of furniture and equipment.
Newspapers, weekly	6 to 12 times most recent annual net profit plus the value of real property.
Optometric Practices	.55 to .65 times three-year average net revenue.
Print Shops, Commercial	5 to 6 times average monthly net sales.
Real Estate Agencies	1.5 times net operating profit plus the value of furniture and equipment.
Travel Agencies	.06 to .07 times annual sales volume.
Veterinary Practices	.9 times average annual net revenue plus the value of equipment and furniture.
Video Tape Rental & Sales Shops	1.5 times net operating profit plus the value of furniture fixtures and equipment.

Source:* <u>*Small Business Valuation Formulas,*</u> *second edition, by Glenn Desmond and John Marcello, 1988.

APPENDIX 2-D

BUSINESS VALUATION EXERCISE BACKGROUND AND ANSWERS

BUY/SELL AGREEMENT

THIS AGREEMENT is made and entered into this 15th day of January, 2000, by and between Paris Printing Company, an Iowa partnership (hereinafter referred to as "Seller"), John and Sylvia Smith (hereinafter referred to, collectively, as the "Smiths"), and Andrew C. Sando, of Waterloo, Iowa (hereinafter referred to as "Buyer").

WHEREAS, Seller owns and operates one printing company located at 1 North Main Street, Waterloo, Iowa (hereinafter referred to as the "Premises");

WHEREAS, Seller occupies the Premises under a warranty deed for Block 16, Section 2, Clinton Heights, Addition to the City of Waterloo (commonly known as 1 North Main Street, Waterloo, Iowa);

WHEREAS, Buyer desires to purchase the inventory, furniture, equipment, supplies, land and building owned and used by Seller in its printing company located at the Premises;

WHEREAS, Seller desires to sell the inventory, furniture, equipment, supplies, land and building owned and used by it in its printing company located at the Premises;

NOW, THEREFORE, for good consideration and subject to the terms and conditions of this Agreement, the parties hereto hereby agree as follows:

I. **Sale of Business**. Seller hereby agrees to sell, and Buyer hereby agrees to purchase:

1. All furniture, equipment, and supplies regularly used by the Seller in the operation of its printing company at the Premises and located at the Premises as of the date of Closing; and
2. All trade fixtures used in the operation of Seller's printing company at the Premises; and
3. The land and building encompassing the Premises (Block 16, Section 2, Clinton Heights, Addition to the City of Waterloo (commonly known as 1 North Main Street, Waterloo, Iowa) the following assets.

All of the above described in paragraphs 1, 2, and 3, above are hereinafter referred to collectively, as the "Business".

II. **Purchase Price.** The Purchase Price for the Business shall be the sum of the amounts determined pursuant to paragraphs 1 and 2, below.

1. The portion of the Purchase Price attributable to the furniture, equipment, supplies and fixtures being sold pursuant to this Agreement, shall be $130,000.
2. The portion of the Purchase Price attributable to the land and building, shall be $125,000.

III. **Payment of Purchase Price.** The Purchase Price shall be paid as follows:

1. Deposit of $60,000 herewith paid by Buyer.
2. Amount of $40,000 to be carried by Seller @10% fixed interest for a period of five years.
3. The Buyer shall pay the balance of the Purchase Price to the Seller, in full, by certified check or wire transfer, at the Closing.

IV. **Instruments of Conveyance and Transfer.** Seller warrants it has good and legal title to said property, full authority to sell said property, and that said property shall be sold by warranty bill of sale free and clear of all liens, encumbrances, liabilities and adverse claims of every nature and description whatsoever. At the Closing, the Seller and the Smiths shall deliver, or cause to be delivered, to the Buyer, such warranty deeds, bills of sale and other instruments of transfer, conveyance as shall be necessary, in the reasonable opinion of Buyer's counsel, to transfer the Business.

V. **Non-Assumption of Liabilities.** The Buyer shall not assume any liabilities of Seller, of any nature whatsoever, whether absolute, contingent, or otherwise, by reason of this Agreement of any of the transactions contemplated hereby.

VI. **Collection of Seller's Accounts Receivable.** Buyer shall bill and rebill, at regular intervals (in accordance with Seller's past practices) those accounts receivable owing to Seller as of the time of Closing. The Seller hereby authorizes the Buyer to endorse, in Buyer's favor, Seller's name on all checks and other instruments received by Buyer in the payment of such accounts receivable, and to deposit the same in Buyer's bank accounts. At the end of each business day, the Buyer shall issue its check made payable to the Seller in an amount equal to all payments received on that day that were made with respect to such accounts receivable.

VII. **Miscellaneous.**

1. The parties agree to transfer title AT CLOSING at the address of the Seller.
2. This agreement shall be binding upon and inure to the benefit of the parties, their successors, assigns and personal representatives.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the date first above written.

SELLER:

PARIS PRINTING COMPANY

By:

John Smith
John Smith

Sylvia Smith
Sylvia Smith

BUYER:

Andrew C. Sando
Andrew C. Sando

PARIS PRINTING COMPANY

FINANCIALS

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2002

Sales		$	362,837.91
Cost of Goods Sold:			
Materials and Supplies	$	183,778.46	
Salaries and Wages - Employees		80,926.56	264,705.02
Gross Profit			98,132.89
Operating Expenses:			
Advertising		5,389.00	
Accounting and Legal		1,292.04	
Depreciation		7,739.83	
Dues and Subscriptions		350.00	
Equipment Rental		570.50	
Freight and Express		2,737.85	
Interest		3,200.00	
Insurance		3,152.00	
Group Insurance		1,125.01	
Laundry		637.12	
Machine Service Contract		-	
Miscellaneous		703.85	
Office Supplies		1,684.70	
Repairs		2,110.28	
Refuse Removal		369.00	
Taxes		7,143.45	
Telephone		1,230.96	
Utilities		4,326.46	
Xmas Employee Benefits		270.00	44,032.05
Total Operating Profit (Loss)			54,100.84
Other Income/Expense			
Interest			420.49
Total Other Income (Expense)			420.49
Net Profit			54,521.33

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
BALANCE SHEET
AS OF DECEMBER 31, 2002

ASSETS

Current Assets				
Cash in Bank - Checking	$	1,353.45		
Cash in Bank - Savings		14,530.56		
Accounts Receivable		31,386.28		
Total Current Assets			$	47,270.29
Fixed Assets				
Land		500.00		
Machinery and Equipment		107,412.73		
Furniture and Fixtures		819.55		
Building and Improvements		15,146.62		
Less: Accumulated Depreciation		(95,143.92)		
Net Fixed Assets				28,734.98
Other Assets				
Unexpired Finance Charges				1,048.16
Prepaid Expenses				209.18
Total Assets			$	77,262.61

LIABILITIES AND NET WORTH

Current Liabilities				
Cash in Bank - Checking (Overdraft)	$	-		
Accounts Payable	$	17,287.89		
Payroll Taxes Accrued and Withheld		2,319.91		
Notes Payable - First Capital Bank		3,806.92		
Total Current Liabilities			$	23,414.72
Long-Term Liabilities				
Mortgage Payable - Olive Head		37,000.00		
Notes Payable		-		
Total Long-Term Liabilities				37,000.00
Total Liabilities				60,414.72
Net Worth - January 1, 1999		24,830.36		
Add: Net Profit for the Year		54,521.33		
Deduct: Partner's Withdrawals		62,503.80		
Total Net Worth - December 31, 1999				16,847.89
Total Liabilities & Net Worth			$	77,262.61

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2001

Sales		$	387,482.28
Cost of Goods Sold:			
Materials and Supplies	$	201,208.26	
Salaries and Wages - Employees		75,581.15	276,789.41
Gross Profit			110,692.87
Operating Expenses:			
Advertising		4,923.69	
Accounting and Legal		1,986.00	
Depreciation		9,778.33	
Dues and Subscriptions		310.00	
Equipment Rental		638.76	
Freight and Express		1,243.45	
Interest		2,754.99	
Insurance		4,625.00	
Group Insurance		1,206.28	
Laundry		622.59	
Machine Service Contract		-	
Miscellaneous		477.75	
Office Supplies		920.20	
Repairs		1,520.92	
Refuse Removal		404.30	
Taxes		7,169.23	
Telephone		1,060.55	
Utilities		4,825.82	
Xmas Employee Benefits		-	44,467.86
Total Operating Profit (Loss)			66,225.01
Other Income/Expense			
Interest			281.31
Total Other Income (Expense)			281.31
Net Profit			66,506.32

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
BALANCE SHEET
AS OF DECEMBER 31, 2001

ASSETS

Current Assets				
Cash in Bank - Checking	$	10,798.18		
Cash in Bank - Savings		4,330.08		
Accounts Receivable		36,385.44		
Total Current Assets			$	51,513.70
Fixed Assets				
Land		500.00		
Machinery and Equipment		109,186.43		
Furniture and Fixtures		819.55		
Building and Improvements		5,390.00		
Less: Accumulated Depreciation		(87,404.09)		
Net Fixed Assets				28,491.89
Other Assets				
Unexpired Finance Charges				453.71
Total Assets			$	80,459.30

LIABILITIES AND NET WORTH

Current Liabilities				
Cash in Bank - Checking (Overdraft)	$	-		
Accounts Payable	$	18,604.99		
Payroll Taxes Accrued and Withheld		23.95		
Current Portion of Long-Term Debt		-		
Total Current Liabilities			$	18,628.94
Long-Term Liabilities				
Mortgage Payable		37,000.00		
Notes Payable		-		
Total Long-Term Liabilities				37,000.00
Total Liabilities				55,628.94
Net Worth - January 1, 1998		25,658.17		
Add: Net Profit for the Year		66,506.32		
Deduct: Partners Withdrawals		67,334.13		
Total Net Worth - December 31, 1998				24,830.36
Total Liabilities & Net Worth			$	80,459.30

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2000

Sales			$ 342,186.14
Cost of Goods Sold:			
Materials and Supplies	$ 175,404.31		
Salaries and Wages - Employees	66,031.28		241,435.59
Gross Profit			100,750.55
Operating Expenses:			
Advertising	5,641.42		
Accounting and Legal	400.00		
Depreciation	10,385.99		
Dues and Subscriptions	297.00		
Equipment Rental	480.49		
Freight and Express	1,922.07		
Interest	3,436.73		
Insurance	4,362.80		
Group Insurance	689.84		
Laundry	512.83		
Machine Service Contract	211.00		
Miscellaneous	511.10		
Office Supplies	2,036.94		
Repairs	1,865.49		
Refuse Removal	382.50		
Taxes	6,377.95		
Telephone	1,088.09		
Utilities	5,651.47		
Xmas Employee Benefits	-		46,253.71
Total Operating Profit (Loss)			54,496.84
Other Income/Expense			
Interest			978.15
Total Other Income (Expense)			978.15
Net Profit			55,474.99

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
BALANCE SHEET
AS OF DECEMBER 31, 2000

ASSETS

Current Assets			
Cash in Bank - Checking	$ -		
Cash in Bank - Savings	7,263.43		
Accounts Receivable	37,139.65		
Total Current Assets		$	44,403.08
Fixed Assets			
Land	500.00		
Machinery and Equipment	104,280.43		
Furniture and Fixtures	819.55		
Building and Improvements	5,390.00		
Less: Accumulated Depreciation	(77,625.76)		
Net Fixed Assets			33,364.22
Other Assets			
Unexpired Finance Charges			405.51
Total Assets		$	78,172.81

LIABILITIES AND NET WORTH

Current Liabilities			
Cash in Bank - Checking (Overdraft)	$ 1,669.26		
Accounts Payable	$ 9,624.24		
Payroll Taxes Accrued and Withheld	521.42		
Current Portion of Long-Term Debt - - Concord National Bank	3,699.72		
Total Current Liabilities		$	15,514.64
Long-Term Liabilities			
Mortgage Payable - Olive Head	37,000.00		
Notes Payable	-		
Total Long-Term Liabilities			37,000.00
Total Liabilities			52,514.64
Net Worth - January 1, 1997	31,739.51		
Add: Net Profit for the Year	55,474.99		
Deduct: Partners Withdrawals	61,556.33		
Total Net Worth - December 31, 1997			25,658.17
Total Liabilities & Net Worth		$	78,172.81

INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1999

Sales			$	312,488.92
Cost of Goods Sold:				
Materials and Supplies	$	144,808.44		
Salaries and Wages - Employees		67,040.91		211,849.35
Gross Profit				100,639.57
Operating Expenses:				
Advertising		3,891.68		
Accounting and Legal		275.00		
Depreciation		9,313.51		
Equipment Rental		406.49		
Freight and Express		1,908.52		
Interest		4,325.08		
Insurance		4,183.00		
Group Insurance		685.57		
Laundry		340.18		
Machine Service Contract		1,137.05		
Miscellaneous		1,155.40		
Office Supplies		3,021.55		
Repairs		2,705.16		
Taxes		6,258.33		
Telephone		1,073.29		
Utilities		4,424.79		
Xmas Employee Benefits		316.00		45,420.60
Total Operating Profit (Loss)				55,218.97
Other Income/Expense				
Interest				978.15
Total Other Income (Expense)				978.15
Net Profit				56,197.12

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
BALANCE SHEET
AS OF DECEMBER 31, 1999

ASSETS

Current Assets				
Cash in Bank - Checking	$	4,248.41		
Cash in Bank - Savings		16,060.62		
Accounts Receivable		25,974.89		
Total Current Assets			$	46,283.92
Fixed Assets				
Land		500.00		
Machinery and Equipment		104,280.43		
Furniture and Fixtures		819.55		
Building and Improvements		5,390.00		
Less: Accumulated Depreciation		(67,239.77)		
Net Fixed Assets				43,750.21
Other Assets				
Unexpired Finance Charges				1,150.90
Total Assets			$	91,185.03

LIABILITIES AND NET WORTH

Current Liabilities				
Accounts Payable	$	14,525.14		
Payroll Taxes Accrued and Withheld		212.63		
Current Portion of Long-Term Debt		4,008.03		
Total Current Liabilities			$	18,745.80
Long-Term Liabilities				
Mortgage Payable - Olive Head		37,000.00		
Notes Payable - Concord National Ba		3,699.72		
Total Long-Term Liabilities				40,699.72
Total Liabilities				59,445.52
Net Worth - January 1, 1996		-		
Add: Net Profit for the Year		56,197.12		
Deduct: Partners Withdrawals		53,642.94		
Total Net Worth - December 31, 1996				2,554.18
Total Liabilities & Net Worth			$	61,999.70

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1998

Sales			$ 290,528.18
Cost of Goods Sold:			
Materials and Supplies	$ 132,566.71		
Salaries and Wages - Employees	63,536.77		196,103.48
Gross Profit			94,424.70
Operating Expenses:			
Advertising	4,489.25		
Accounting and Legal	550.00		
Depreciation	9,313.51		
Equipment Rental	152.59		
Freight and Express	2,030.00		
Interest	4,728.88		
Insurance	4,000.00		
Group Insurance	685.57		
Laundry	358.83		
Machine Service Contract	1,589.76		
Miscellaneous	555.45		
Office Supplies	2,099.76		
Repairs	500.00		
Taxes	6,058.89		
Telephone	1,677.78		
Utilities	4,824.86		
Xmas Employee Benefits	-		43,615.13
Total Operating Profit (Loss)			50,809.57
Other Income/Expense			
Interest			667.89
Total Other Income (Expense)			667.89
Net Profit			51,477.46

PARIS PRINTING COMPANY
1 NORTH MAIN STREET, WATERLOO, IOWA
BALANCE SHEET
AS OF DECEMBER 31, 1998

ASSETS

Current Assets				
Cash in Bank - Checking	$	5,933.10		
Cash in Bank - Savings		16,060.62		
Accounts Receivable		25,974.89		
Total Current Assets			$	47,968.61
Fixed Assets				
Land		500.00		
Machinery and Equipment		104,280.43		
Furniture and Fixtures		819.55		
Building and Improvements		5,390.00		
Less: Accumulated Depreciation		(67,239.77)		
Net Fixed Assets				43,750.21
Other Assets				
Unexpired Finance Charges				1,150.90
Total Assets			$	92,869.72

LIABILITIES AND NET WORTH

Current Liabilities				
Accounts Payable	$	14,525.14		
Payroll Taxes Accrued and Withhel		212.63		
Notes Payable				
Current Portion of Long-Term Debt		4,238.87		
Total Current Liabilities			$	18,976.64
Long-Term Liabilities				
Mortgage Payable - Olive Head		37,000.00		
Notes Payable - Concord National I		7,707.75		
Total Long-Term Liabilities				44,707.75
Total Liabilities				63,684.39
Net Worth - January 1, 1995		27,295.76		
Add: Net Profit for the Year		51,477.46		
Deduct: Partners Withdrawals		49,587.89		
Total Net Worth - December 31, 1995				29,185.33
Total Liabilities & Net Worth			$	92,869.72

PARIS PRINTING COMPANY

EXERCISE ANSWERS

Paris Printing Company

Adjusted Book Value

Seller's Balance Sheet adjusted for assets not acquired, liabilities not assumed, and fair market value of assets acquired

Book Value Net Worth			16,847.89
Less:			
	Cash - Checking	(1,353.45)	
	Cash - Savings	(14,530.56)	
	Accounts Receivable	(31,386.28)	
	Unexpired Finance Charges	(1,048.16)	
	Prepaid Expenses	(209.18)	(48,527.63)
Plus:			
	Accounts Payable	17,287.89	
	Payroll Taxes Accrued & Withheld	2,319.91	
	Notes Payable - First Capital Bank	3,806.92	
	Mortgage Payable - Olive Head	37,000.00	60,414.72
Appraised Value, R/E		125,000.00	
Appraised Value, M&E		130,000.00	
Less Book Value, F/Assets:		(28,734.98)	226,265.02
Net Worth Adjustments:			
Adjusted Book Value:			255,000.00
		Rounded	**255.0**
			Valuation

Paris Printing Company
Gross Revenue Multiplier

Calculate the business value based on the rule of thumb for this industry (print shop, commercial):

FY 2002 Net Sales:		362,837.91	
	Average (Net Sales/12)	30,236.49	
	6 Times Average Monthly	181,418.96	
		181.4	**Valuation**

Paris Printing Company

Capitalized Adjusted Earnings

Step 1: Adjust Historical Earnings					
	2002	**2001**	**2000**	**1999**	**1998**
Net Profit	54,521.33	66,506.32	55,474.99	56,197.12	51,477.46
Adjustments	-	-	-	-	-
New Owner Salary	(25,000.00)	(25,000.00)	(25,000.00)	(25,000.00)	(25,000.00)
Adjusted Net Profit	29,521.33	41,506.32	30,474.99	31,197.12	26,477.46
Rounded	29,500.00	41,500.00	30,500.00	31,200.00	26,500.00

Note: Net Profit is Not Adjusted for Officer's Salaries since this is a partnership & salaries are taken directly from Net Worth and not included in Expenses.

Step 2: Calculate Weighted Average of Adjusted Earnings

Year	Earnings	Weight	Total
2002	29.5	5	147.5
2001	41.5	4	166.0
2000	30.5	3	91.5
1999	31.2	2	62.4
1998	26.5	1	26.5
Total	159.2	15	493.90
	31.8		**32.9**

Average

Weighted Average

Step 3: Calculate a Discount Rate	
Assumed discount rate	15%

Step 4: Calculate the Weighted Average Divided by Discount Rate		
$32.9/.15 =	**219.5**	**Valuation**

Paris Printing Company

Discounted Future Earnings

Step 1: Adjust Historical Earnings

	2002	2001	2000	1999	1998
Net Profit	54,521.33	66,506.32	55,474.99	56,197.12	51,477.46
Adjustments	-	-	-	-	-
New Owner Salary	(25,000.00)	(25,000.00)	(25,000.00)	(25,000.00)	(25,000.00)
Adjusted Net Profit	29,521.33	41,506.32	30,474.99	31,197.12	26,477.46
Rounded	29,500.00	41,500.00	30,500.00	31,200.00	26,500.00

Note: Net Profit is Not Adjusted for Officer's Salaries since this is a partnership & salaries are taken directly from Net Worth and not included in Expenses.

Step 2: Calculate Weighted Average of Adjusted Earnings

YEAR	EARNINGS	WEIGHT	TOTAL
2002	29,500.00	5	**$ 147,500**
2001	41,500.00	4	**$ 166,000**
2000	30,500.00	3	**$ 91,500**
1999	31,200.00	2	**$ 62,400**
1998	26,500.00	1	**$ 26,500**
		15	**$ 493,900**

* AMOUNT INCLUDES : NET PROFIT + INTEREST + OWNER'S DRAW.

(DEPRECIATION MAY BE ADDED ONLY IF SELLER USED "ACCELERATED DEPRECIATION ")

VALUE	WEIGHT	= AVERAGE
$ 493,900.00	15	$32,926.67

Step 3: Determine the Discount Rate 15%

Step 4: Determine the Inflation Rate 5%

Step 5: Determine the Present Value

YEAR	EARNINGS	INFLATION RATE		DISCOUNT FACTOR	VALUE
1st	32926.67	1.05	34573.00	.86957	30063.64
2nd	34573.00	1.05	36301.65	.75614	27449.13
3rd	36301.65	1.05	38116.73	.65752	25062.51
4th	38116.73	1.05	40022.57	.57175	22882.90
5th	40022.57	1.05	42023.70	.49718	20893.34
6th	42023.70	1.05	44124.88	.43233	19076.51
7th	44124.88	1.05	46331.13	.37594	17417.72
8th	46331.13	1.05	48647.68	.32690	15902.93
9th	48647.68	1.05	51080.07	.28426	14520.02
10th	51080.07	1.05	53634.07	.24718	13257.27
TOTAL PRESENT VALUE :					**$ 206,525.98**

Valuation

Paris Printing Company
Cash Flow Method

Step 1: Identify Available Cash for Debt Service

	Last Year	Rounded
Net Profit	54,521.33	
+Depreciation	7,739.83	
Adjusted Profit	62,261.16	**62.3**

Step 2: Choose Reasonable Maturity & Market Interest Rate

	Years
Business Equipment	10
Real Estate	15
Average Maturity	**12.5**

Interest Rate **12%**

Step 3: Compute the Amount of Funds the Cash Flow can Support

62.3 @12.5 years @12% interest = **393.3**

Valuation

Note: If Valuation is performed using monthly instead of annual rates, the Business would be valued at 402.3

APPENDIX 2-E

PROFORMA
EXAMPLES

PROFORMA FOR A START-UP BUSINESS

Enter Date/Type														
ASSETS	R		R		R		R	Start-up	R	Debit	R	Credit	R	ProForm
Cash									a)	30,000				30,000
Accounts Rec														0
Inventory									b)	50,000				50,000
Cost in Excess														0
Other Current														0
Total Current		0		0		0		0		80,000		0		80,000
Fixed Assets									c)	125,000				125,000
Other Assets														0
Prepaid Exp														0
TOTAL ASSETS		0		0		0		0		205,000		0		205,000
Enter # days		365		365		365								365
DEBT / WORTH														
Accts Payable														0
Curr. Mat. LTD														0
Other Debt														0
Taxes Payable														0
Current SBA											d)	4,200		4,200
Other														0
Bill in Excess														0
Total Current		0		0		0		0		0		4,200		4,200
Notes Payable														0
SBA											d)	120,800		120,800
Due to Owners														0
Other LTD														0
Total LTD		0		0		0		0		0		120,800		120,800
TOTAL LIAB		0		0				0		0		125,000		125,000
C/P Stock / Treasury														0
Paid-In Cap														0
Retained Earn														0
Total Worth		0								0	abc)	80,000		80,000
DEBT & WORTH		0		0		0		0		205,000		205,000		205,000

Balance Sheet Adjustments/Comments:

SBA Loan $125,000.00 - 15 years @ 8.75%

a) Cash injection by applicant for working capital $10,000.00
SBA/Bank loan proceeds for working capital $20,000.00.

b) Cash injection by applicant towards purchase of inventory $20,000.00
SBA/Bank loan proceeds to complete purchase of inventory $30,000.00.

c) Cash injection by applicant towards purchase of land & building $50,000.00
SBA/Bank loan proceeds to complete purchase of land & building $75,000.00.

d) SBA/Bank loan payments.

PROFORMA - EXISTING BUSINESS - DEBT REFINANCING - REQUIRED ADJUSTMENTS

Enter Date/Type								Interim						
ASSETS	R		R		R		R	8/31/2002	R	Debit	R	Credit	R	ProForm
Cash								20,000						20,000
Accounts Rec								30,000						30,000
Inventory								30,000						30,000
Due From Stockholder								20,000			a)	20,000		0
Other Current														0
Total Current		0		0		0		100,000		0		20,000		80,000
Fixed Assets								130,000						130,000
Other Assets								25,000			b)	25,000		0
Prepaid Exp														0
TOTAL ASSETS		0		0		0		255,000		0		45,000		210,000
Enter # days		365		365		365								365
DEBT / WORTH														
Accts Payable														0
Curr. Mat. LTD								20,000						20,000
Other Debt								25,000	c)	25,000				0
Taxes Payable														0
Current SBA											e)	4,200		4,200
Due to Stockholder								20,000	d)	20,000				0
Bill in Excess														0
Total Current		0		0		0		65,000		45,000		4,200		24,200
Notes Payable								100,000	c)	100,000				0
SBA											e)	120,800		120,800
Due to Owners														0
Other LTD														0
Total LTD		0		0		0		100,000		100,000		120,800		120,800
TOTAL LIAB		0		0				165,000		145,000		125,000		145,000
C/P Stock / Treasury														0
Paid-In Cap														0
Retained Earn														0
Total Worth		0						90,000	ab)	45,000	d)	20,000		65,000
DEBT & WORTH		0		0		0		255,000		190,000		190,000		210,000

Balance Sheet Adjustments/Comments:

SBA Loan $125,000.00 - 15 years @ 8.75%

a) Deletion of loan due from stockholder with adjustment to net worth.

b) Deletion of goodwill with adjustment to net worth.

c) SBA/Bank loan proceeds to satisfy debt.

d) Deletion of loan due to stockholder as a liability with a credit to net worth (standby required).

e) SBA/Bank loan payments.

PROFORMA - PURCHASING ASSETS OF AN EXISTING BUSINESS

Enter Date/Type														
ASSETS	R		R		R		R		R	Debit	R	Credit	R	ProForm
Cash														0
Accounts Rec														0
Inventory														0
Cost in Excess														0
Other Current														0
Total Current		0		0		0		0		0		0		0
Fixed Assets									a)	500,000				500,000
Other Assets														0
Prepaid Exp														0
TOTAL ASSETS		0		0		0		0		500,000		0		500,000
Enter # days		365		365		365								365
DEBT / WORTH														
Accts Payable														#VALUE!
Curr. Mat. LTD														0
Other Debt														0
Taxes Payable														0
Current SBA											a)	20,500		20,500
Other														0
Bill in Excess														0
Total Current		0		0		0		0		0		20,500		20,500
Notes Payable														0
SBA											a)	379,500		379,500
Due to Owners														0
Other LTD														0
Total LTD		0		0		0		0		0		379,500		379,500
TOTAL LIAB		0		0				0		0		400,000		400,000
C/P Stock / Treasury														0
Paid-In Cap														0
Retained Earn														0
Total Worth		0								0	a)	100,000		100,000
DEBT & WORTH		0		0		0		0		500,000		500,000		500,000

Balance Sheet Adjustments/Comments:

a) To record the purchase of fixed assets at cost in a business buyout, SBA loan proceeds and applicant's equity injection.

NOTE: On business buyouts, do not record the selling company's balance sheet information. Make all entries in the "debit" & "credit" columns.

APPENDIX 2-F

IRS FORM 4506 – REQUEST FOR COPY OR TRANSCRIPT OF TAX FORM

SBA

U.S. Small Business Administration

Form **4506**

(Rev. May 1997)

Department of the Treasury
Internal Revenue Service

Request for Copy or Transcript of Tax Form

Read instructions before completing this form.

Type or print clearly. Request may be rejected if the form is incomplete or illegible.

OMB No. 1545-0429

Note: ***Do not*** *use this form to get* ***tax account information.*** *Instead, see instructions below.*

1a Name shown on tax form. If a joint return, enter the name shown first.

1b **First social security number on tax form or employer identification number** (See instructions.)

2a If a joint return, spouse's name shown on tax form

2b **Second social security number on tax form**

3 Current name, address (including apt., room, or suite no.), city, state, and ZIP code

4 Address, (including apt., room, or suite no.), city, state, and ZIP code shown on the last return filed if different from line 3.

5 If copy of form or a tax return transcript is to be mailed to someone else, enter the third party's name and address.

6 If we cannot find a record of your tax form and you want the payment refunded to the third party, check here . . . . ☐

7 If name in third party's records differs from line 1a above, enter that name here (see instructions)

8 Check only one box to show what you want. There is no charge for items 8a, b, and c:

- **a** ☐ Tax return transcript of Form 1040 series filed during the **current calendar year** and the **3 prior calendar years.** (see instructions).
- **b** ☐ Verification of nonfiling.
- **c** ☐ Form(s) W-2 information (see instructions).
- **d** ☐ Copy of tax form and all attachments (including Form(s) W-2, schedules, or other forms). **The charge is $23 for each period requested.**
  Note: *If these copies must be certified for court or administrative proceedings, see instructions and check here* . . . . ☐

9 If this request is to meet a requirement of one of the following, check all boxes that apply.

☐ Small Business Administration ☐ Department of Education ☐ Department of Veterans Affairs ☐ Financial institution

10 **Tax form number** (Form 1040, 1040A, 941, etc.)

11 **Tax period(s)** (year or period ended date). If more than four, see instructions.

12 Complete only if line **8d** is checked. Amount due:

- **a** Cost for each period . . . .
- **b** Number of tax periods requested on line 11 . . .
- **c** Total cost. Multiply line 12a by line 12b . . . . . . $

Does not apply to SBA transcript requests

Full payment must accompany your request. Make check or money order payable to "Internal Revenue Service."

Caution: *Before signing, make sure all items are complete and the form is dated.*

I declare that I am either the taxpayer whose name is shown on line 1a or 2a, or a person authorized to obtain the tax information requested. I am aware that based upon this form, the IRS will release the tax information requested to any party shown on line 5. The IRS has no control over what that party does with the information.

Please Sign Here

Signature. See instructions. If other than taxpayer, attach authorization document. Date

Title (if line 1a above is a corporation, partnership, estate, or trust)

Spouse's signature Date

Telephone number of requester

Best time to call

TRY A TAX RETURN TRANSCRIPT (see line 8a instructions)

Instructions

Section references are to the Internal Revenue Code.

TIP: If you had your tax form filled in by a paid preparer, check first to see if you can get a copy from the preparer. This may save you both time and money.

Purpose of Form.—Use Form 4506 to get a tax return transcript, verification that you did not file a Federal tax return, Form W-2, information, or a copy of a tax form. Allow 6 weeks after you file a tax form before you request a copy of it or a transcript. For W-2 information, wait 13 months after the end of the year in which the wages were earned. For example, wait until Feb. 1999 to request W-2 information for wages earned in 1997.

Do not use this form to request Forms 1099 or tax account information. See this page for details on how to get these items.

Note: *Form 4506 must be received by the IRS within 60 calendar days after the date you signed and dated the request.*

How Long Will It Take?—You can get a tax return transcript or verification of nonfiling within 7 to 10 workdays after the IRS receives your request. It can take up to 60 calendar days to get a copy of a tax form or W-2 information. To avoid any delay, be sure to furnish all the information asked for on Form 4506.

Forms 1099.—If you need a copy of a Form 1099, contact the payer. If the payer cannot help you, call or visit the IRS to get Form 1099 information.

Tax Account Information.—If you need a statement of your tax account showing any later changes that you or the IRS made to the original return, request tax account information. Tax account information lists

(Continued on back)

This form was electronically produced by Elite Federal Forms, Inc.

certain items from you return, including any later changes.

To request tax account information, write or visit an IRS office or call the IRS at the number listed in your telephone directory.

If you want your tax account information sent to a third party, complete **Form 8821,** Tax Information Authorization. You may get this form by phone (call 1-800-829-3676) or on the Internet (at http://www.irs.ustreas.gov).

Line 1b.—Enter your employer identification number (EIN) **only** if you are requesting a copy of a **business** tax form. Otherwise, enter the first social security number (SSN) shown on the tax form.

Line 2b.—If requesting a copy or transcript of a joint tax form, enter the second SSN shown on the tax form.

Note: *If you do not complete line 1b and, if applicable, line 2b, there may be a delay in processing your request.*

Line 5.—If you want someone else to receive the tax form or tax return transcript (such as a CPA, an enrolled agent, a scholarship board, or a mortgage lender), enter the name and address of the individual. If we cannot find a record of your tax form, we will notify the third party directly that we cannot fill the request.

Line 7.—Enter the name of the client, student, or applicant if it is different from the name shown on line 1a. For example, the name on line 1a may be the parent of a student applying for financial aid. In this case, you would enter the student's name on line 7 so the scholarship board can associate the tax form or tax return transcript with their file.

Line 8a.—If want a tax return transcript, check this box. Also, on line 10 enter the tax form number and on line 11 enter the tax period, for which you want the transcript.

A tax return transcript is available for any returns of the 1040 series (Form 1040, Form 1040A, 1040EZ, etc.). It shows most line items from the original return, including accompanying forms and schedules. In many cases, a transcript will meet the requirement of any lending institution such as a financial institution, the Department of Education, or the Small Business Administration. It may also be used to verify that you did not claim any itemized deductions for a residence.

Note: *A tax return transcript* ***does not*** *reflect any changes you or the IRS made to the original return. If you want a statement of your tax account with the changes, see* ***Tax Account Information*** *on page 1.*

Line 8b.—Check this box only if you want proof from the IRS that you did not file a return for the year. Also, on line 11 enter the tax period for which you want verification of nonfiling.

Line 8c.—If you want only Form(s) W-2 information, check this box. Also, on line 10 enter "Forms(s) W-2 only" and on line 11 enter the tax period for which you want the information.

You may receive a copy of your actual Form W-2 or a transcript of the information, depending on how your employer filed the form. However, state withholding information is not shown on a transcript. If you have filed your tax return for the year the wages were earned, you can get a copy of the actual Form W-2 by requesting a complete copy of your return and paying the required fee.

Contact your employer if you have lost your current year's Form W-2 or have not received it by the time you are ready to prepare your tax return.

Note: *If you are requesting information about your spouse's Form W-2, your spouse must sign Form 4506.*

Line 8d.—If you want a certified copy of a tax form for court or administrative proceedings, check the box to the right of line 8d. It will take at least 60 days to process your request.

Line 11.—Enter the year(s) of the tax form or tax return transcript you want. For fiscal-year filers or requests for quarterly tax forms, enter the date the period ended; for example, 3/31/96, 6/30/96, etc. If you need more than four different tax periods, use additional Forms 4506. Tax forms filed 6 or more years ago may not be available for making copies. However, tax account information is generally still available for these periods.

Line 12c.—Write your SSN or EIN **and** "Form 4506 Request" on your check or money order. If we cannot fill your request, we will refund your payment.

Signature.—Requests for copies of tax forms or tax return transcripts to be sent to a third party must be signed by the person whose name is shown on line 1a or by a person authorized to receive the requested information.

Copies of tax forms or tax return transcripts for a jointly filed return may be furnished to either the husband or the wife. Only one signature is required. However, see the line 8c instructions. Sign Form 4506 exactly as your name appeared on the original tax form. If you changed your name, **also** sign your current name.

For a corporation, the signature of the president of the corporation, or any principal officer and the secretary, or the principal officer and another officer are generally required. For more details on who may obtain tax information on corporations, partnerships, estates, and trusts, see section 6103.

If you are **not** the taxpayer shown on line 1a, you must attach your authorization to receive a copy of the requested tax form or tax return transcript. You may **attach a copy of the authorization document** if the original has already been filed with the IRS. This will generally be a **power of attorney** (Form 2848), or **other authorization,** such as Form 8821, or evidence of entitlement (for Title 11 Bankruptcy or Receivership Proceedings). If the taxpayer is deceased, you must send Letters Testamentary or other evidence to establish that you are authorized to act for the taxpayer's estate.

Where To File.—Mail Form 4506 with the correct total payment attached, if required, to the **Internal Revenue Service Center** for the place where you lived when the requested tax form was filed.

Note: *You must use a separate form for each service center from which you are requesting a copy of your tax form or tax return transcript.*

If you lived in:	Use this address:
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	1040 Waverly Ave. Photocopy Unit Stop 532 Holtsville, NY 11742
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	310 Lowell St. Photocopy Unit Stop 679 Andover, MA 01810
Florida, Georgia, South Carolina	4800 Buford Hwy. Photocopy Unit Stop 91 Doraville, GA 30362
Indiana, Kentucky, Michigan, Ohio, West Virginia	P.O. Box 145500 Photocopy Unit Stop 524 Cincinnati, OH 45250
Kansas, New Mexico, Oklahoma, Texas	3651 South Interregional Hwy. Photocopy Unit Stop 6716 Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	P.O. Box 9941 Photocopy Unit Stop 6734 Ogden, UT 84409
California (all other counties), Hawaii	5045 E. Butler Avenue Photocopy Unit Stop 52180 Fresno, CA 93888
Illinois, Iowa, Minnesota, Missouri, Wisconsin	2306 E. Bannister Road Photocopy Unit Stop 57A Kansas City, MO 64999
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	P.O. Box 30309 Photocopy Unit Stop 46 Memphis, TN 38130
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, a foreign country, or A.P.O. or F.P.O address	11601 Roosevelt Blvd. Photocopy Unit DP 536 Philadelphia, PA 19255

Privacy Act and Paperwork Reduction Act Notice.—We ask for the information on this form to establish your right to gain access to your tax form or transcript under the Internal Revenue Code, including sections 6103 and 6109. We need it to gain access to your tax form or transcript in our files and properly respond to your request. If you do not furnish the information, we will not be able to fill your request. We may give the information to the Department of Justice or other appropriate law enforcement official, as provided by law.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping,** 13 min.; **Learning about the law or the form,** 7 min.; **Preparing the form,** 26 min.; and **Copying, assembling, and sending the form to the IRS,** 17 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the form to this address. Instead, see **Where To File** on this page.

APPENDIX 2-G

IRS TAX RETURN VERIFICATION CENTERS

IRS Tax Return Verification Centers

(Revised 4/29/02)

IRS Center	ADDRESS	MANAGER	PHONE	FAX
Andover	310 Lowell St. Stop 679 Andover, MA 01810	Muriel Hogan	978-691-6904	978-691-6859 978-691-6893 978-691-6896
Atlanta	4800 Buford Hgwy. Stop 91 Doraville, GA 30362	Scott Morehead	678-530-5319	678-530-5326 678-530-5327
Austin	3651 S. Interregional Hwy. Stop 6716 Austin, TX 78741	Adell Daniels	512-460-2255	512-460-2272 512-460-2354
Brookhaven	1040 Waverly Ave. Stop 532 Holtsville,NY 11742	Deb LoVerde	631-654-6387	631-447-4405 631-447-4576 631-654-6243
Cincinnati	P.O. Box 145500 Stop 2801A Cincinnati, OH 45250	Todd Grover	859-669-3585	859-669-3592
Fresno #1	5045 E. Butler Stop 28106 Fresno, CA 93888	Linda Wade	559-443-7866	559-443-7853 559-443-7596
Fresno #2	5045 E. Butler Stop 28106 Fresno, CA 93888	Jim Garcia	559-443-7826	559-443-7822 559-443-7823
Kansas City	2306 E. Bannister Rd. Stop 6700 Annex 1 Kansas City, MO 64131	Darline Nickle	816-823-7639	816-823-7667 816-823-7668 816-823-7669
Memphis	P.O. Box 30309 Stop 2826 Memphis, TN 38130	Pat Thomas	901-546-4133	901-546-4175
Ogden	P.O. Box 9941 Stop 6734 Ogden, UT 84409	Lisa Rose	801-334-4170	801-334-4178
Philadelphia	11601 Roosevelt Blvd Drp 536 Philadelphia, PA 19255	Jackie Egolf	215-516-3944 215-516-6900	215-516-1311 215-516-1322 215-516-2931

APPENDIX 2-H

SAMPLE COVER MEMORANDUM TO IRS

TO: IRS Service Center

FROM: Lender
City, State

SUBJECT: Request for Return Information

Pursuant to an agreement between IRS and the Small Business Administration (SBA), we are requesting return information as specified on the attached Form(s) 4506, Request for Copy or Transcript of Tax Form, with the signed consent of the taxpayer(s). Each taxpayer is either an approved applicant for a loan whose repayment is guaranteed by the U.S. Small Business Administration or a participant in an SBA-sponsored program. The requested information will be used to determine the prospective borrower's suitability for a loan or participation in an SBA-sponsored program.

For individual return information, we request an RTFTP transcript. For corporate or partnership return information, please furnish the data listed on Letter 1722B.

Please return the requested information to:

(Name and address of Lender)

If you have any questions, please contact (Name, title and telephone number of Lender employee).

Thank you.

APPENDIX 2-I

IRS SAMPLE LETTER

Internal Revenue Service
Department of the Treasury

Person to Contact:

Telephone Number:

Employer Identification Number:

Addressee

Dear Taxpayer:

In reply to your inquiry of ______________, our records show the following:

Method of Accounting ____Cash ____Accrual ____Other
Calendar Yr. ____Yes ____No

Tax Year(s)

Net Sales/Receipts	_________	_________	_________
Cost of Goods Sold	_________	_________	_________
Salaries and Wages	_________	_________	_________
Depreciation	_________	_________	_________
Interest (Deduction)	_________	_________	_________
Taxable/Ordinary Income	_________	_________	_________
Inventory End of Year	_________	_________	_________
Accounts Payable	_________	_________	_________
Partner's Capital Account	_________	_________	_________
Retained Earnings-Unappro.	_________	_________	_________

We have no record that you filed a return for tax year(s) ____________.

If you need additional information, you may request a copy of your return from the service center where you filed your return.

If you have any questions concerning this matter, please call or write our office. Use the telephone number or address shown above. Whenever you write to us, please enclose a copy of this letter and include your daytime telephone number and the best time for us to call you.

Sincerely,

APPENDIX 2-J

ENVIRONMENTAL INDEMNIFICATION AND REMEDIATION AGREEMENT

ENVIRONMENTAL INDEMNIFICATION AND REMEDIATION AGREEMENT

[NAME OF INDEMNITOR], a [NAME OF STATE] Corporation, ("Indemnitor") enters into this Environmental Indemnification and Remediation Agreement ("Agreement") in order to induce [NAME OF LENDER] ("Lender") and the United States Small Business Administration ("SBA") to provide a loan to [NAME OF BORROWER] ("Borrower").

For valuable consideration and intending to be bound legally, the undersigned parties agree as follows:

1. Definitions.

For purposes of this Agreement, the following definitions apply:

1.1. "Environment" shall have the meaning set forth at 42 U.S.C. § 9601.

1.2. "Release" means any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the Environment.

1.3. "Contaminant" means any substance that is hazardous or detrimental to the Environment and which is regulated by law, including, without limitation, any hazardous substance (as that term is defined at 42 U.S.C. § 9601), and petroleum (as that term is defined at 42 U.S.C. § 6991).

1.4. "Agency" means any Federal, state or local governmental agency with statutory or regulatory authority to enforce laws regarding the release of any Contaminant into the Environment.

1.5. "Property" means [INSERT ADDRESS] now owned by Indemnitor, and described in greater detail in the mortgage that will be executed by Borrower for the benefit of Lender and SBA to secure a loan made to finance Borrower's purchase of the Property from Indemnitor. The term "Property" also includes groundwater.

1.6. "ESA Report" means a Phase II report or other report that contains the results from an Environmental Site Assessment of the Property which involved the physical sampling and analysis of surface waters, subsurface waters, land surface, or subsurface strata, at all locations at the Property where a diligent inquiry has determined that there is a potential for any Contaminant to exist, to determine the existence, nature, and quantitative volume of Contaminants that were released on or into the Property. Such inquiry will include, at a minimum, an inspection of the Property and adjacent properties, review of relevant site records, review of any relevant Agency files, and interviews with persons knowledgeable about site operations (<u>e.g.</u>, current owner and its employees, neighbors, etc.). The ESA Report is identified as follows: [NAME OF REPORT, DATE AND NAME OF COMPANY THAT PREPARED REPORT].

1.7. "Remediation" means investigation, remediation, clean-up, and monitoring, including all actions within the definition of "removal" and "remedial" actions as those terms are defined in 42 U.S.C. § 9601.

1.8. "Indemnitor" includes: (1) any parent or subsidiary corporation of Indemnitor, and (2) any affiliated corporation of Indemnitor (<u>i.e.</u> any corporation that is owned by the same parent corporation that owns Indemnitor).

1.9. When describing the release of a contaminant "on" the Property, such term encompasses the release of a contaminant "on, into, under, from or above" the Property, and includes any Contaminant originally Released on the Property that subsequently migrates to another site.

2. <u>Recitals</u>.

2.1. Borrower desires to purchase the Property, and has submitted applications to Lender and SBA for loan which is to be secured by the Property.

2.2. Activities at the Property prior to the transfer of the Property to Borrower may have resulted in the release of Contaminants that may be hazardous or detrimental to the Environment.

2.3. The ESA Report indicates that there has been a release of a Contaminant on the Property, and that Remediation is or may be necessary under law.

2.4. Lender and SBA will not make a loan to Borrower unless they are provided with indemnification from Indemnitor against losses they may sustain as the result of Agency actions or third party claims regarding the release of any Contaminant on the Property.

2.5. Indemnitor desires to assist Borrower in its efforts to secure loans from Lender and SBA by agreeing to perform Remediation of Contaminants released on the Property prior to the transfer to Borrower, and to provide indemnification from any related demand, claim or suit, in accordance with the terms of this Agreement.

3. Remediation and Investigation Obligations.

3.1. Indemnitor agrees, at its sole cost and expense, to cause to be performed such Remediation of all Contaminants on the Property that were identified in the ESA Report described in paragraph 1.6 above which may be required by any Agency. Such Remediation obligations shall continue until such time as any Agency exercising authority over the Remediation at the Property approves such actions and provides written notice that no further action will be required.

3.2 Indemnitor warrants that it has no knowledge of any release of any Contaminant on the Property, other than the Contaminant(s) identified in the ESA Report, which has not been completely Remediated .

3.3. In the event that any Contaminant, not identified in the ESA Report, is found to have been released on the Property prior to the transfer of the Property to Borrower, Indemnitor further agrees, at its sole cost and expense, to cause to be performed Remediation of any such Contaminant, which may be required by any Agency. Such Remediation obligations shall continue until such time as any Agency exercising authority over the Remediation at the Property approves such actions and provides written notice that no further action will be required.

3.4. In the event that Indemnitor completes its Remediation obligations under paragraphs 3.1 or 3.3, and any Agency subsequently requires Remediation of any Contaminant for which Indemnitor Is responsible under this Agreement, Indemnitor will perform such Remediation until the responsible Agency approves such actions and provides written notice that no further action will be required. Indemnitor's obligations shall continue until full repayment of the loan or satisfaction of the debt owed SBA/Lender.

4. Indemnity from Claims. Indemnitor further agrees to indemnify, defend and hold harmless Lender and SBA, and any assigns or successors in interest which take title to the Property, from and against all liabilities, damages, fees, penalties or losses arising out of any demand, claim or suit by any Agency or any other party relating to any Contaminant for which Indemnitor is responsible under this Agreement.

5. Manner of Performance.

5.1. Indemnitor shall perform Remediation in a prompt manner and in compliance with all applicable laws, and in a manner and at times which will not unreasonably interfere with Borrower's use of the Property.

5.2. Indemnitor warrants that it has exercised due care in selecting the contractor that prepared the ESA Report to ensure that the contractor (1) is qualified and competent to perform the environmental investigation; (2) has obtained any license or certification necessary for the performance of such investigation; and (3) is not an employee of Indemnitor or of any company or organization in which Indemnitor has any ownership interest or has any other conflict or potential conflict of interest.

5.3. Indemnitor further warrants that it has exercised due care in selecting the contractor that prepared the ESA Report to ensure that the contractor has obtained all necessary insurance to cover its failure to perform any errors or omissions in its environmental investigation, and agrees to assign to SBA, Lender, Borrower or any of their assigns, upon request, any such rights Indemnitor may have to make a claim upon such insurance policy.

5.4. Indemnitor further warrants that it has exercised due care to ensure that the environmental site assessment that served as the basis for the ESA Report was consistent with the definition in paragraph 1.6 above.

6. Cooperation To Indemnitor. Borrower, Lender, SBA, and any of their assigns and successors in interest who take title to the Property shall provide reasonable cooperation to Indemnitor (1) to allow Indemnitor to cause to be performed any Remediation and (2) to allow Indemnitor to conduct its defense of any claim or suit, for which Indemnitor is responsible under paragraph 4 above. This shall include, but not be limited to, Indemnitor's being given access to the Property, without cost to Indemnitor, so as to allow Indemnitor to undertake any investigation or Remediation that it believes may be necessary to comply with its obligations under this Agreement. Such access must be at reasonable times, and upon reasonable notice by Indemnitor to the occupant (or if there is none) the owner of the Property.

7. Reporting Requirements

7.1. Indemnitor shall promptly provide Lender, SBA and Borrower with copies of any written communications between Indemnitor and any Agency regarding Remediation. As its sole option, Lender, SBA and/or Borrower may waive in writing the right to obtain some or all of such communications.

7.2. Indemnitor shall promptly provide Borrower, Lender and SBA with a copy of (1) any written communication received from any Agency regarding any Contaminant released on or into the Property for which Indemnitor may be responsible under this Agreement, and (2) any notice of any demand, claim or suit referenced in paragraph 4 for which Indemnitor may be responsible.

7.3. Borrower, Lender and SBA shall promptly provide Indemnitor with a copy of (1) any written communication received from any Agency regarding any Contaminants released on or into the Property for which Indemnitor may be responsible under this Agreement, and (2) any notice of any demand, claim or suit referenced in this Agreement for which Indemnitor may be responsible.

8. Parties.

8.1. In the event that Borrower, Lender and/or SBA transfers or assigns the Property to a third party and provides Indemnitor with written notice of this transfer or assignment, Indemnitor's obligations under this Agreement shall also extend to such assignee or transferee. Borrower, Lender and SBA may undertake such transfer or assignment without Indemnitor's consent.

8.2. Indemnitor shall not transfer or assign any of its obligations under this Agreement to any other party without the express written consent of Lender, SBA or their transferee or assignee.

9. Interpretation and Execution of Agreement.

9.1. All provisions contained in this Agreement are severable and the invalidity or non-enforceability of any provision shall not affect or impair the validity or enforceability of the remaining provisions of this Agreement.

9.2. This Agreement constitutes the entire agreement between the parties and, to the extent there is a conflict, supersedes (1) all prior agreements and understandings between Indemnitor and either Lender or SBA not expressly referred to herein, both written and oral with respect to the subject matter contained in this Agreement, and (2) any Agreement that Indemnitor has executed or will execute with the Borrower addressing the remediation of or indemnification related to any Contaminant that has been Released on the Property for which Indemnitor is responsible under this Agreement. Any amendments or modifications hereto, in order to be effective, shall be in writing and executed by the parties hereto.

9.3. This Agreement may be executed in one or more identical counterparts each of which shall be deemed an original, and all of which, taken together, shall constitute one and the same Agreement.

9.4. Failure by Borrower, Lender or SBA (or any of their assigns) to undertake any obligation under this Agreement, or exercise reasonable care in undertaking such obligation, shall not be construed as releasing Indemnitor from any obligations under this Agreement. Any such failure will not preclude Indemnitor from pursuing any right that may exist under law to obtain recovery from the responsible party.

10. <u>Notices</u>

All notices required under this Agreement shall be made to the following:

(1) All notices to SBA shall be made to District Counsel, Small Business Administration, [INSERT ADDRESS].

(2) All notices to Lender shall be made to [INSERT NAME OF OFFICIAL, NAME OF LENDER AND ADDRESS].

(3) All notices to Borrower shall be made to [INSERT NAME OF OFFICIAL, NAME OF BORROWER AND ADDRESS].

(4) All notices to Indemnitor shall be made to [INSERT NAME OF OFFICIAL,

NAME OF INDEMNITOR AND ADDRESS].

11. Authority To Sign.

By signing below, each individual represents and warrants that he or she has proper authority to execute this Agreement. Indemnitor has attached as Exhibit "A" to this Agreement a valid, certified resolution, unlimited power of attorney, or other evidence confirming such authority.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the latest date set forth below.

[INDEMNITOR]

Dated: ________________ By:

PRINT NAME: ______________________

TITLE: ____________________________

[LENDER]

Dated: ________________ By:

PRINT NAME: ______________________

TITLE: ____________________________

U.S. SMALL BUSINESS ADMINISTRATION

Dated: ________________ By:

PRINT NAME: ______________________

TITLE: ____________________________

[BORROWER]

Dated: ________________ By:

PRINT NAME: ______________________

TITLE: ____________________________